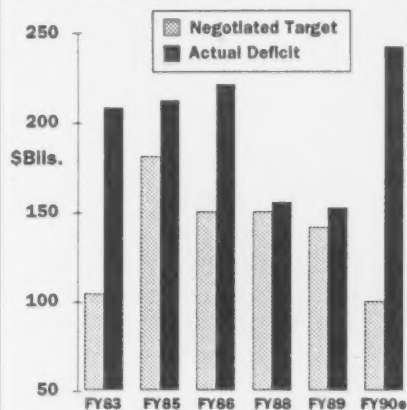


Tax Features

Summitry Takes a Fall As Budget Process Breaks Down

A decade of budget summitry culminated in defeat for both President Bush and his congressional counterparts at the summit, but especially for the very idea of high-level budgetary negotiations. For the sixth time in nine

Budget Summits' Deficit Targets vs. Actual Deficits



years, the White House and congressional leaders held special negotiations to reduce the federal deficit. The package they agreed on was quite similar to the product of previous summits, a combination of tax increases and promised spending restraints. But instead of being passed by a reluctant Congress, the summit agreement ran into a hornet's nest of congressional critics willing to defy their party leaders and vote down the budget resolution.

These opponents cited again and again the simple fact that high-level budget talks held in 1982, 1984, 1985, 1987 and 1989 all fell far short of their stated goals (see figure above and the Tax Foundation Issue Brief, *Decade of Budget Summitry*, June 1990). In fact, a summit-arranged budget has never even reduced the deficit below the level of the summit year, and the 1989 summit was the biggest failure of

See Summitry on page 7

FRONT BURNER

Attacking the Budget Deficit: Two Views



Congressman Leon Panetta (D-CA)



Congressman Newt Gingrich (R-GA)

On pp. 2-3, Congressman Leon Panetta, chairman of the House Budget Committee and Congressman Newt Gingrich, House Republican Whip, address one of the nation's front burner issues: How can we ease our current budgetary gridlock and reduce the deficit?

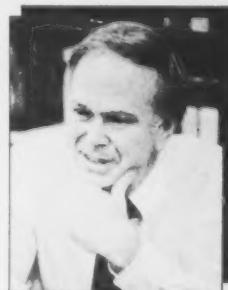
The opinions expressed in the Front Burner are not necessarily those of the Tax Foundation. Editorial replies are encouraged.

Senator Bob Packwood to Receive 1990 Distinguished Public Service Award

Bob Packwood, Republican senator from Oregon, will receive the Tax Foundation's Distinguished Public Service Award at the Foundation's 53rd Annual Dinner on December 5th at the Waldorf-Astoria Hotel in New York City. A major policy address by the senator will follow his acceptance.

Senator Packwood is the Ranking Minority Member of the Senate Finance Committee and was its chairman from 1984 to 1986 when he was a prime mover behind the Tax Reform Act of 1986.

The dinner will follow the Foundation's 42nd Annual Conference. Its two sessions will focus on ideas for improving the federal budget process and new developments in state/local taxes.



Senator Bob Packwood (R-OR)



Tax Foundation

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The Budget Process Must Move Forward

By Congressman Leon E. Panetta

The budget resolution adopted by the Congress with bipartisan support on October 8 is the essential first step in the budget process. It contains the savings and deficit reduction targets agreed to by the President and the bipartisan Congressional leadership. Now, Congressional committees are beginning the legislative process of implementing the spending cuts and tax increases needed to achieve the \$40 billion/\$500 billion deficit-reduction targets agreed to for fiscal year 1991 and fiscal years 1991-95 respectively.

President Bush — who deserves great credit for putting his prestige on the line for this budget — has called the package a tough agreement for tough times. Too often, Presidents have not been willing to deliver that message

"President Bush — who deserves great credit for putting his prestige on the line for this budget — has called the package a tough agreement for tough times. Too often, Presidents have not been willing to deliver that message when it was needed."

when it was needed. That is one of the reasons we now must enact a \$500 billion deficit-reduction package.

But the reality is, we are a nation at risk — at risk militarily in the Middle East; at risk politically in a world of shifting power and relationships; at risk economically, with a rising likelihood of recession, a slow but steady erosion of our position in the world economy, and a frustrating inability to respond to difficult issues here at home; and at risk from the specter of mindless sequestration, drastic across-the-board cuts in some of this nation's most critical programs, from education to defense.

The huge budget deficits that have piled up over the past decade have robbed the resources we need for investment in our future. Savings, which should go into new businesses and economic growth, are instead financing government borrowing. And the taxes we ask the American people to pay out of their hard-earned dollars must go to pay interest on that borrowing instead of financing improvements in education or rebuilding the nation's transportation system.

The Treasury's extraordinary borrowing has pushed up interest rates. Now, at a time of very slow growth, high interest rates can submerge the economy, pulling it down into recession.

The economy is on the brink, and those who play partisan or political games — or power games — should know there is a terrible price to be paid. Growth in the second quar-

ter was less than half a percent, and that was before the impact of high energy prices. The combination of a soft economy, oil shock, inflation, and sequester will send the markets reeling and endanger the financial stability of both the national and international economy.

This agreement is not a panacea for our short-term economic problems, but deficit reduction is essential for giving the Federal Reserve the latitude it needs to reduce interest rates and mitigate the depth and duration of a recession. Furthermore, deficit reduction is the only proven tool for assuring long-term growth in investment, productivity, employment, and incomes. That is why Federal Reserve Chairman Greenspan said before the vote on the budget that if it were voted down, "prospects for coming to grips with the corrosive effects of budget deficits on our economy would be dim indeed."

This is by far the largest and most real deficit reduction measure ever seriously contemplated by the Congress or by any President. It requires tough choices in the areas we have always known would have to be involved in a deficit-reduction plan — defense, entitlement programs, and taxes. And it lasts five years — no tricks, no smoke and mirrors.

Is it perfect? Far from it. Is it painful? With half a trillion dollars in deficit reduction, how could it not be? Is it the package that any single member of Congress — or the President — would have constructed? Absolutely not. It is a

"We are a nation at risk ... economically, with a rising likelihood of recession, a slow but steady erosion of our position in the world economy, and a frustrating inability to respond to difficult issues here at home."

compromise, which means that everybody gives up something for the greater good. That's what democracy is all about, particularly at a time of divided government. Members of Congress need to remember that we were elected not only to represent a particular point of view, but to govern.

Passage of the budget resolution has moved the process forward. It was supported by a majority of both Democrats and Republicans in the Senate, and a majority of Democrats and a significant minority of Republicans in the House. Those who supported it rose above parochial concerns, regional interests, and ideology and partisanship and cast a vote for the greater good of this country — for our nation's future, for our children's future. To implement the budget agreement will require that they — and hopefully others — do so at least one more time.



Congressman Leon E. Panetta (D-CA)

Leon E. Panetta has represented the 16th district of California in the U.S. House of Representatives since 1977. He is currently the chairman of the House Budget Committee and the Deputy Majority Whip.

Bad Tax Policy Makes Bad Social Policy

By Congressman Newt Gingrich

In America, tax policy is social policy. Every provision in the tax code sends a signal to society, and we ought to be sending signals that are pro-family, pro-growth, pro-savings, pro-entrepreneurship, pro-work and pro-children. The current tax code does just the opposite, and the recently rejected summit agreement was unfortunately just as bad.

It was an insiders' package that took care of the needs of Washington at the expense of the American people. It did so by raising taxes while it increased domestic discretionary spending. Even more disheartening was the almost total absence of economic incentives; those of us who want to encourage growth have been very disappointed. What are some provisions that would have helped make the summit agreement a success?

"The recently rejected summit agreement ... took care of the needs of Washington at the expense of the American people ... by raising taxes while it increased domestic discretionary spending."

First, based on a bill introduced by Senators Kasten and Mack and Congressman Mickey Edwards, the capital gains tax would be reduced to 7.5 percent for individuals in the 15-percent bracket and to 15 percent for individuals and corporations in the 28-percent bracket. It would also be indexed for inflation so that when Americans invest, they do not have to be afraid that their government will defraud them by inflating the currency.

Second, based on Congresswoman Nancy Johnson's bill, manufacturers would be allowed to expense up to \$250,000 a year in productive equipment investment. This is not a big deal for large corporations, but it is a very big deal

"The capital gains tax [should] be reduced to 7.5 percent for individuals in the 15-percent bracket and to 15 percent for [those] in the 28-percent bracket."

for small suppliers or for anyone who wants American small business to have the new equipment needed to compete in the world market.

Third, based on S. 1256 by Senator Bill Roth, after-tax, non-deductible contributions to individual retirement accounts or plus accounts would be allowed in amounts up to

Newt Gingrich has represented the 6th district of Georgia in the U.S. House of Representatives since 1979. He was elected House Minority Whip in 1989.



Congressman Newt Gingrich (R-GA)

\$2,000 per taxpayer per year, including non-working spouses. Up to 25 percent of the funds could be withdrawn interest-free or tax-free to purchase a first home, college education for children or grandchildren, or for catastrophic medical expenses. By building an incentive to save into the tax code, we would be saying to Americans: We want you to save for your education, we want you to save to buy housing, we want you to save for health care, and we want you to save for retirement.

Lastly, my staff and I are writing what I am calling the Harry S. Truman child tax credit. A devastating measure of how far the code has become biased against families, against children, and against workers, in favor of government bureaucracy, can be taken by looking back to 1948, when Truman was president. If we allowed American taxpayers to take the same deduction per child, as a percentage of income, that they could in 1948, it would be \$6,300. In addition, in 1948, the maximum Social Security tax was \$30 a year — today it is \$3,924. And people wonder why so many children live in poverty and why so many families break up. We have designed a tax code and a welfare code that says: If you stay together, we will punish you; if you break up, we

"If we allowed American taxpayers to take the same deduction per child, as a percentage of income, that they could in 1948, it would be \$6,300."

will give you public housing. Is it any wonder we have the problems we have?

The President and congressional leaders offered the American people a budget package that simply did not address these problems, while suggesting that there were no responsible alternatives. I have mentioned some specific, constructive proposals, but speaking more generally, there are at least three alternatives to this type of budget package. The Congress has 13 appropriations bills that the President can veto if they exceed the limits he sets. Another alternative is for the President to go to the country and ask people to put pressure on Congress to pass the right kind of tax cuts to create jobs. Third, by restricting federal budget growth to no more than four percent per year, we could balance the budget by 1997.

This is a diverse and imaginative country. The proponents of the summit package who predicted economic chaos if that particular budget agreement did not pass simply had it wrong. The sun has continued to come up; the Constitution is still in place; and we can return to the drawing board to get another, more sound, budget plan for our country.

International Taxation Seminar Addresses Taxation of Both Inbound and Outbound Foreign Investment

The Tax Foundation's seminar on U.S. tax treatment of foreign investment was held September 25 in Washington, D.C. Four panels of speakers from government, industry and academia gave their perspectives on U.S. tax treatment of U.S. investment abroad and foreign investment in the U.S. Over 100 tax executives, legislative and executive branch staff, and members of the business press were in attendance.

Keynote speaker Congressman Hank Brown (R-CO) of the House Ways and Means Committee, suggested that this year's budget package is likely to include provisions designed to crack down on FCDs and other domestic operations of foreign companies. "I think there is . . . a 50/50 chance . . . that you could see the tax on the foreign transfer of ownership provision added," Brown said.

Dr. Edward M. Graham, senior research fellow at the Institute for International Economics, presented an issue overview. He pointed out the dramatic increase in both U.S. participation in foreign firms as well as foreign direct investment in the U.S. However, the U.S. still has a lower rate of foreign direct investment than France, Germany or the U.K., according to Graham. "U.S. policy should do nothing to discourage either inward or outward investment," Graham concluded.

Richard M. Hammer, International Tax Partner at Price Waterhouse and

Chairman of the U.S. Council for International Business's Tax Committee, added that "the more that tax policy tilts against foreign multinationals in the



Deputy International Tax Counsel Peter Barnes at left elicits a wry smile from Raymond Haas, international tax partner at Ernst & Young.

United States, the more possibility there is that the tax policy of other nations will be tilted against U.S. subsidiaries and their operations in those countries."

Hammer also addressed superroyalties, the application of intercompany transfer pricing concepts to the area of intangible property rights. He went on to say that superroyalties lead to double taxation. "I don't know what to do about [it] except to go down to Congress and ask them to change the rules When you are looking for revenue, you get pretty desperate. I think this is a case of desperation."

Unfortunately it is more than complexity of rules that bedevils U.S. tax law and the policy behind it, according to Hammer. "What is really troublesome in foreign tax policy is more of a case . . . of legal changes enacted without serious thought being given to the underlying policy; of a failure to update tax policy to a modern economic and investment climate; of over-concentration on stamping out potential abuses without focusing on how

such . . . amendments fit into the overall scheme."

U.S. investment abroad was also addressed by Raymond Haas, International Tax Partner, Ernst & Young; Murray Schlusel, Assistant General Counsel - International Tax, Ford Motor Company; Peter A. Barnes, Deputy International Tax Counsel, U.S. Department of Treasury; B. Anthony Billings, Tax Foundation Senior Research Fellow and Professor of Accounting, Wayne State University; and John F. Brussel, Tax Director - International, AT&T. David M. Crowe, Partner, Caplin & Drysdale, and Robert N. Mattson, Assistant Treasurer of IBM were the panel chairmen.

The third and fourth panels focused on the inbound transactions of foreign investment. An issue overview was presented by Elliot L. Richardson,

"The more that tax policy tilts against foreign multinationals in the United States, the more possibility there is that the tax policy of other nations will be tilted against U.S. subsidiaries and their operations in those countries."

— Richard M. Hammer



From left: Tax Foundation Director of Corporate Development Ronald Bunn, Congressman Hank Brown (R-CO), Tax Foundation Vice President Dan Witt, and Co-Chairman of the Tax Foundation, James C. Miller III.

senior resident partner at Milbank, Tweed, Hadley & McCloy, and Chairman, Association for International Investment.

According to Richardson, the U.S. is dealing with a situation in which the corporate domicile of the corporation and the place where the preponderance of its shareholders may live, is increasingly irrelevant to the determination of rational policies. Where the employees are, where the customers are, may be much more significant.

This raises the question of where responsibility should lie and harmonization and consistency can be achieved. "The most useful effort that could now go forward would be one that seeks to

bring about [a] maximum practicable level of coordination among countries," Richardson added. "It obviously makes sense that in an era of 24-hour securities trading around the world that there should be harmonization in securities laws."

Bruce R. Bartlett, Deputy Assistant Secretary for Economic Policy, U.S. Department of Treasury asserted, "The investment climate of a nation is the fundamental determinant of foreign investment." This means that increasing foreign investment in the U.S. is a sign of strength, not weakness. It also means that it is probably impossible to have a strong economy without foreign investment, according to Bartlett.

Less investment will mean fewer jobs, lower productivity, and a lower rate of growth. Thus, the price for reducing our dependence on foreign capital would be very high, he said.

It is an unsound economic policy that does not promote the involvement of Americans in investment overseas and investment in the U.S. from abroad, added Congressman Philip M. Crane (R-IL), a member of the House Ways and Means Committee and the Ranking Minority Member of the Subcommittee on Trade. He asserted that most of the emotional argument against foreign investment is thinly disguised bashing of the Japanese.

Compliance and transfer pricing was discussed by James M. Carter, Senior Tax Counsel, ICI Americas; and Secretary, Organization for the Fair Treatment of International Investment. "The figure of \$25 billion was mentioned recently as the amount by which



Congressman Phil Crane (R-IL) provided a historical perspective on the antipathy of some Americans toward foreign investment.

the U.S. subsidiaries of foreign based multinationals have cheated, evaded, or defrauded the U.S. government out of taxes. The examples that are being given to demonstrate how that is done simply don't hold water," Carter said.

"You take advantage of the tax laws as you find them, and in that respect the U.S. subsidiary of a foreign multinational is no different from the U.S. company that is owned by U.S. shareholders," he added. "Instead of trying to force foreign

countries to use the same kind of rules to tax their people, the U.S. Congress ought to be looking at how to relieve the tax burden on the U.S.-owned companies." He concluded by saying, "Instead of throwing stones and calling these nasty old foreigners are cheating us, we ought to try to bring some rationality to the tax scheme. We ought to try to do it on a cooperative basis."

Peter A. Barnes, Deputy International Tax Counsel at the U.S. Department of the Treasury, pointed out that some proposals made by other panelists in the name of simplification or equity would garner much less tax revenue and were therefore out of the question, especially in the midst of a budget crisis. On simplification issues, he said, "What I would encourage you to do is not to walk away just discouraged by all the problems that are cre-

ated for foreign-owned U.S. companies or U.S.-owned foreign companies, but instead to go back and revisit the smaller issues that we might usefully approach over the next year."

Other speakers included Catherine T. Porter, Partner, Miller & Chevalier; Harrison J. Cohen, Legislation Counsel, Joint Committee on Taxation; and Richard Pratt, Economic Counsellor, Embassy of Great Britain. Robert Ashby, Assistant Vice President, Taxes, Northern Telecom Inc.; and John G. Wilkins, Partner, Coopers & Lybrand, were the third and fourth panel chairmen.

Proceedings of the seminar will soon be available from the Foundation.



From left: Tax Foundation Director of Fiscal Affairs Paul Merski; Elliot Richardson, former Secretary of Commerce and currently Senior Resident Partner at Milbank, Tweed, Hadley & McCloy; and Tax Foundation Vice President Dan Wut.

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Tax Foundation President Wayne Gable listens to Margaret Debandbutter of the European Community Chamber of Commerce in the U.S., Inc.



Patrick J. Moran, Vice President, Fiscal Legislation, Merck & Co., speaks with Peter Barnes who presented the Treasury Department's views to the seminar.

Government and Your Tax Dollar

How Governments Raise the Money They Spend

Almost 28 cents of every dollar raised by federal, state and local governments comes from individual income taxes, according to analysis of FY1988 data (latest reported). That totaled more than \$489 billion of the \$1.776 trillion that governments collected that year.

FICA Gaining Fast

Although the individual income tax has been the most prodigious government revenue raiser for over 40 years, it is being overtaken by other taxes. State and local taxes have grown at a rapid pace, as have nontax revenues, but the fastest growing of all tax sources from 1960 to 1988 was Social Security payroll taxes, rising from 7.0 cents per dollar of revenue in 1960 to 17.5 cents in 1988. Social Security tax collections in 1988 were \$310 billion, 25 times as large as in 1960. Other major revenue raisers included:

- Current charges, 9.8 cents;

See *Government Taxing on page 8*

How Federal, State, and Local Governments Raise Each Dollar of Public Funds

Selected Fiscal Years 1960-1988

(Cents Per Dollar of Total Revenue)

Source	1960	1970	1980	1987	1988
Tax Revenues	82.7	82.4	76.2	74.2	74.9
Individual Income	28.2	30.3	30.7	28.4	27.6
Social Security (OASDHI)	7.0	11.5	15.0	16.4	17.5
Property	10.7	10.2	7.3	7.2	7.4
Selective Sales and excises	12.5	9.8	6.5	5.7	5.8
Corporate Income	14.8	11.0	8.4	6.3	6.6
General Sales	3.5	4.8	5.5	5.8	5.9
Other taxes(a)	6.0	4.8	4.8	4.3	4.0
Nontax Revenues	17.3	17.6	21.8	25.9	25.1
Current Charges	8.1	7.9	8.6	9.7	9.8
Miscellaneous general (b)	3.3	4.0	6.7	7.6	7.1
Employee retirement	1.9	2.5	3.1	5.0	4.6
Utilities and liquor stores	3.2	2.6	2.7	3.0	3.0
Other nontaxes	0.8	0.6	0.7	0.6	0.6
Exhibit (\$Billions):					
Total Revenues	\$153.1	\$333.8	\$932.2	\$1,677.1	\$1,776.4
Surplus (+) or deficit(-)	\$1.8	\$8	-\$26.5	-\$132.9	-\$144.0

^a Includes death and gift, motor vehicle and operators licenses, unemployment contributions, and miscellaneous taxes.

^b Includes interest earnings, special assessments, sale of property, and other general revenue.

Source: Tax Foundation computations based on data from U.S. Department of Commerce, Bureau of the Census.

. . . . And the Ways They Spend the Money They Raise

How Federal, State, and Local Governments Spend Each Dollar of Public Funds

Selected Fiscal Years 1960-1988

(Cents Per Dollar of Total Revenue)

Source	1960	1970	1980	1987	1988
Major social welfare programs, total	20.1	25.5	33.2	32.4	32.6
Social Security (OASDHI)	7.1	10.8	15.6	15.6	15.6
Social services and income maintenance ^a	8.5	10.7	13.2	12.8	12.9
Government employee retirement	2.0	2.4	3.1	3.1	3.2
Veterans (not elsewhere classified)	2.5	1.6	1.3	1.0	1.0
National defense and international relations	32.3	25.3	15.6	17.6	17.2
Education	12.8	16.7	15.0	13.3	13.4
Interest on general debt	6.2	5.5	7.9	10.4	10.5
Environment and housing	5.4	4.4	5.0	7.0	6.7
Utilities and liquor stores	3.4	2.8	3.8	3.8	3.7
Transportation	7.6	6.2	4.5	3.7	3.7
Public Safety	1.8	2.0	2.3	3.4	3.5
Government administration	1.8	1.9	2.2	2.4	2.5
Postal service (Federal)	2.5	2.3	1.9	1.8	1.8
Sanitation	1.1	1.0	1.4	1.2	1.2
All other	5.0	6.4	7.2	3.0	3.2
Exhibit (\$Billions):					
Total spending	\$151.3	\$330.0	\$958.7	\$1,810.0	\$1,920.4

^a Includes public welfare, hospitals, health, social insurance administration, and other insurance trust expenditures.

Source: Tax Foundation computations based on data from U.S. Dept. of Commerce, Bureau of the Census.

Social welfare programs consumed 32.6 cents of every government dollar spent in 1988 (latest reported). Almost one third of 1988 public expenditures, some \$627 billion out of total spending by all levels of government of \$1.92 trillion, supported the social welfare network.

Other spending categories which consume a major chunk of each government dollar spent are:

- National defense and international relations, 17.2 cents;
- Education expenditures, 13.4 cents;
- Interest costs, 10.5 cents; and
- Environment and housing, 6.7 cents.

Social Welfare Spending Dominates

Federal Social Security (OASDHI) is the largest portion of social welfare expenditures and in 1988 was the single costliest spending program, claiming

See *Government Spending on page 8*

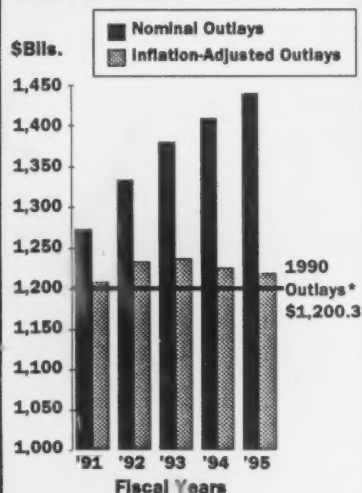
Summary from page 1

all in that regard.

Ironically, the fiscal years that were not preceded by budget summits actually resulted in the most real deficit reduction. In FY1984, the deficit dropped \$23 billion when spending growth was

Estimated Outlays of 1990 Summit Agreement

FY1991 - 1995



* Estimate by Tax Foundation.
Note: All figures exclusive of deposit insurance.

held to 5.4 percent — half the rate of revenue growth for that same year. In FY1987, spending grew only 1.4 percent and the budget deficit fell a record \$71.5 billion.

Did the budget package negotiated by the summit this year deserve its fate? By any standards of sound fiscal policy, it left a lot to be desired. It called for \$162 billion in new revenue over a 5-

"A summit-arranged budget has never even reduced the deficit below the level of the summit year, and the 1989 summit was the biggest failure of all in that regard."

year period, with an assortment of spending restraints and other deficit-reducing measures intended to cut the deficit a total of \$500 billion. The vast

PRESIDENT'S MESSAGE

1986 Tax Reform Did Not Result In Lower Tax Bill for the Rich



Wayne Gable

The verdict is finally in on many aspects of the Tax Reform Act of 1986 (TRA'86). As exasperating as it is to wait years before drawing conclusions on legislation that affects every American's paycheck, wait we must because the tax return data takes at least two years to collect, and 1988 was the first year for which most provisions of TRA'86 were fully implemented. Many snap judgments have been made on the Act's regressive results on individual income taxes, but they have been proven wrong.

The top earning half of the population continues to pay well over 90 percent of the federal individual income tax bill. Despite all the tax legislation witnessed over the past decade, the share of individual income taxes paid by the top earning half of America's taxpayers has varied less than 2 percent — from a low of 92.6 percent in 1982 to a high of 94.5 percent in 1988. In other words, the rich paid a *higher* percentage after tax reform.

The progressivity of the federal income tax system is further demonstrated by the larger share of the total tax burden shouldered by the top ten percent of earners, up from 49.5 percent in 1979 to 56.9 percent in 1988. Their average tax payment in 1988 was \$21,573. While this group of only 11 million tax filers paid well over half the total income taxes in 1988, their adjusted gross income ranged down to \$58,368, not exactly "fat cat" status. It still takes millions of middle and upper-middle income taxpayers to pay the bulk of the total income tax bill.

Pundits have frequently asserted during the 1980s that this productive group of taxpayers has been doing *too* well. And in fact the new data do show that along with paying more in taxes, this group has experienced a high rate of increase in income. If the reduction in rates implemented by the Tax Reform Act of 1986 has resulted in people making more money and therefore paying more money into the Treasury, then apparently the lower rates have succeeded in stimulating economic activity.

When newer data become available, the Tax Foundation will be among the first to issue reports on new developments in our income tax system, but not before. Analysis of the tax burden should be based on actual data, not conjecture.

majority of these spending restraints were scheduled to be implemented in the out years, under the next two congresses. The package contained no significant budget process reforms, and the spending caps did not apply during the first two years of the agreement to revisions in spending because of "technical and economic adjustments."

Nor would they have applied during the remaining three years if the President's representatives and the congressional leadership agreed that revisions were in order.

Even if all the enumerated spending restraints had been implemented, outlays would have been higher every year of the package than they were in fiscal year 1990 (see figure above). In other words, the agreement would not have cut spending as advertised.

Optimistic assumptions were made about the economy and the enforceability of the package, leading wary observers to conclude that the defeated summit agreement would not have reduced the federal budget deficit by \$500 billion, if at all.

Government Taxing from page 6

■ Property taxes levied by state and local governments, 7.4 cents;

■ Miscellaneous general revenue (i.e., interest earnings and government asset sales), 7.1 cents;

■ Selective sales and excise taxes and general sales taxes, 5.8 and 5.9 cents respectively;

■ Corporate income taxes, 6.6 cents; and

■ Miscellaneous taxes (death and gift, motor vehicle and operators licenses, unemployment contributions and others), 4.0 cents.

Taxes Grow Fast But Spending Grows Faster

Figures on government revenues don't always tell the whole story. In fact, they understate the amount spent by government in 1988 by \$144 billion. The federal government financed \$202 billion — almost one fourth of its outlays by borrowing.

State and local governments, on the other hand, took in \$57 billion (6.9 percent) more than they spent, thus reducing the deficit for all governments combined to \$144 billion, or 7.9 cents per dollar of spending. The fiscal 1988 deficit for all governments was almost six times the amount shown in 1980, and 8 percent larger than the deficit recorded just a year earlier.

Additional details appear in the table at the top of page 6.

Government Spending from page 6

15.6 cents of every dollar spent. Social welfare programs also include social services and income maintenance (public welfare, health and hospitals, and unemployment insurance), which accounted for 12.9 cents per dollar of government spending. Other social welfare programs included are government employee retirement, and veterans' programs not elsewhere classified, 4.2 cents.

Two Decades of High Growth

During the 1960s and 1970s, spending on social welfare programs underwent a dramatic increase, rising from 20.1 cents per dollar in 1960 to 33.2 cents in 1980. Spending on social programs in 1988 came to 16 times what it had been in 1960, whereas all other programs combined increased tenfold over the same period.

Education and Transportation Spending Down

Another notable recent trend has been the relative decline in spending for education and transportation. Education spending accounted for 15 cents per dollar in 1980. It now absorbs only 13.4 cents. Transportation expenditures continue their sharp decline. They now stand at only 3.7 cents, less than half 1960 levels.

Debt Payments Rise

The fastest growing component of all government costs have been debt-

related outlays. Interest payments on government debt claimed 10.5 cents of each dollar spent in 1988, compared to a 7.9 cent bite in 1980 and 6.2 cents in 1960. Total government interest payments may be a misleading figure because most of this interest cost is due to the federal debt which was over \$2.6 trillion in fiscal year 1988.

The four largest spending categories — major social welfare programs, defense, education and interest payments — accounted for well over \$1.4 trillion, or 73.7 cents of every dollar of federal, state, and local expenditures in 1988.

The table at the bottom of page 6 provides further details.

Tax Features

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December 5th at the
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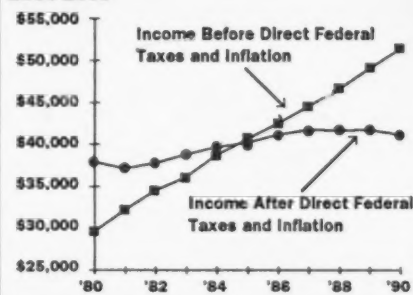
Tax Features

U.S. Family's Real Income To Drop in 1990 Due to Higher Taxes and Inflation

The one-two punch of rising inflation and direct federal taxes will reduce the purchasing power of the U.S. family's income in 1990. A

Median Family Income Before and After Direct Federal Taxes and Inflation

1980-1990



typical family—a household with two earners employed full-time year round with two dependent children—will experience a net decrease in real income of \$614 in 1990 after adjusting for direct federal taxes (see figure above). This is the most substantial decline

See Median Family Income on page 5

William S. Kanaga to Receive Distinguished Service Award At 1990 Annual Dinner



William S. Kanaga

William S. Kanaga, former chairman and chief executive officer of Arthur Young & Co., will receive the Foundation's Distinguished Service Award for the Private Sector. Senator Bob Packwood is the public sector award recipient. The occasion will be the Foundation's 53rd annual dinner on December 5. For details on attending the dinner and the 42nd annual national conference beforehand, see page 7.

Budget Plays Shell Game with American People



Senator William Roth

I once heard that the definition of the Eiffel Tower is the Empire State Building after taxes. I'm afraid that this definition will take on new meaning with the recently approved budget package. Not only has Congress further stripped financial wherewithal from the American taxpayer, but it is one more step toward taking a strong economy and turning it into a shell.

I voted against the budget because it meets virtually none of the criteria America needs to meet its future in an increasingly competitive world. Some tried to sell the package as a bipartisan success that provides \$490 billion of deficit reduction over the next five years. But, what we really have is a package that includes \$200 billion in new revenue made up of tax increases, user fees and increased Medicare premiums. The rest is \$70 billion in domestic spending reductions, \$180 billion in defense savings and \$64 billion in savings on interest on the national debt. This does not include the increased spending, tax breaks, and income redistribution, all of which detract from deficit reduction.

A closer look at the budget, especially the tax components, illustrates the real burden it will have on the American public and our economy. Proponents argue that the net tax figure is \$137 billion, but in reality total tax increases will hit \$164 billion. The \$27 billion difference includes tax breaks and income redistribution.

See Roth on page 2

Senator William Roth, Republican from Delaware, serves on the Senate Committee on Finance.

The opinions expressed in the Front Burner are not necessarily those of the Tax Foundation. Editorial replies are encouraged.



Tax Foundation

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Roth from page 1

The increase in Health Insurance wage base, the phase-out of personal exemptions, and the reduction of itemized deductions are only three of 26 different tax increases in the budget — many of which will hit the middle class right on the chin. While the taxes in this proposal are for certain, the spending reductions aren't.

Only \$70 billion of this package are real reductions — reductions in Medicare, Federal Employee Retirement, Veterans programs, student loans and

"Not only has Congress further stripped financial wherewithal from the American taxpayer, but it is one more step toward taking a strong economy and turning it into a shell."

agriculture. New revenue increases outpace entitlement savings three to one. Under this so-called deficit reduction plan, total government spending will be \$100 billion higher in 1991 than it was in 1990.

Even during this time of austerity, this legislation builds in increasing spending for discretionary programs. If there were guarantees that these increases were necessary, it would be

"[There are] 26 different tax increases in the budget — many of which will hit the middle class right on the chin."

one thing. Unfortunately, these guarantees don't exist. We are already hearing of discretionary funds to be used for renovating the home of Lawrence Welk, studying the potential for a national bicycle policy, as well as looking for a place to build a new Congressional staff gym. In other words, Congress not only passed the buck — but spent it.

Concerning defense cuts, the \$180

billion of this package counted as defense savings may very well be real, but is not the result of the budget negotiations. It represents a windfall due to the

"We are already hearing of discretionary funds to be used for renovating the home of Lawrence Welk, studying the potential for a national bicycle policy, as well as looking for a place to build a new Congressional staff gym. In other words, Congress not only passed the buck — but spent it."

communist meltdown. And, like a windfall, this \$180 billion is fortunate at best and illusory at worst.

Another component of the package is the \$64 billion in reduced interest payments on the national debt. This figure is based on extremely optimistic interest rate assumptions and has very little to do with the hard choices Congress must make to get the deficit under control.

Some would argue that the deficit reductions are for real. But even the proponents of the package admit that Gramm-Rudman is only advisory during the first three years — with no bite to limit spending. The so-called spending caps intended to monitor spending

"Only \$70 billion of this package are real reductions — reductions in Medicare, Federal Employee Retirement, Veterans programs, student loans and agriculture. New revenue increases outpace entitlement savings three to one."

through the year are so flexible that spending will continue to increase

during the next five years. These caps or ceilings allow for emergency spending increases as well as inflationary adjustments. However, nowhere in the bill is there an allowance for emergency tax cuts to stimulate the economy in a recession.

In addition to their rubber-like flexibility, these caps will have no effect on IRS funding increases, credit re-estimates, Egyptian debt forgiveness, additional IMF contributions, emergency supplementals and Operation Desert Shield.

For all of these reasons, I believe the budget package fails the American people. It will fail their economic needs. It tries to lay the blame of the deficit and budget debacle at their feet. It tries to make them believe that the problem is not that Congress is spending too much — or that the government is wasting money — but that they are not being taxed enough. I don't believe it and neither do they. Treasury revenue has

"Under this so-called deficit reduction plan, total government spending will be \$100 billion higher in 1991 than it was in 1990."

doubled in ten years — due to the economic boom provided by the tax cuts of 1981. Even that windfall wasn't enough for the big spenders.

After this tax agreement, Americans have as much reason and right to rebel as they had in 1774

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U.S. Transfer Pricing Provisions Ignore Economic Realities of the 1990s

The complexity of U.S. tax provisions on foreign source income bedevils U.S. multinational firms. But when looking at American tax policy's problems in the foreign area, complexity is only the tip of the iceberg. Tax laws are changed without serious thought to the underlying tax policy; tax policies are not updated to the modern investment climate; and perceived tax law abuses are addressed with no regard to how the cure fits into the scheme of American foreign tax policy. What these problems really amount to is a failure by Congress, perhaps even a complete abdication of its responsibility for shaping a coherent and sensible foreign tax policy.

In this broad range of issues, I will focus on how U.S. transfer pricing rules affect domestic transactions, both inbound and outbound, even though the glare of recent publicity has been on the transfer pricing practices of foreign-owned companies bringing their products to the U.S.

From an overall policy perspective, the U.S. subscribes to the well-known "arms length" standard in transfer pricing. This generally keeps the U.S. in line with the rest of the world, most of whom adhere strictly to this standard. However, the U.S. has gradually reduced its dependence on true market evidence in establishing what is, or is not, arms-length. So far, these deviations from true market price have been restricted to narrow areas such as the safe-haven or administrative pricing formulae of the Domestic International Sales Corporation (DISC) and the Foreign Sales Corporation (FSC).

Recently proposals have been discussed on Capitol Hill which would introduce a rigid 50/50 profit split on products

productive economically and result in a nightmare when determining appropriate royalty adjustments.

Enacting the superroyalty provisions, Congress felt geographic rights to intangibles were being transferred to foreign affiliates before their full value was achieved in the United States. They considered this deleterious because the costs of developing the associated patent or "know how" were borne by and may have benefited from the liberal U.S. R&D relief rules. If so, the revenues from the technology should accrue to the U.S. parent, not to the foreign affiliates which may have had little to do with developing the patent (used interchangeably with intangible).

In spite of opposition from American businesses having foreign affiliates, Congress insisted on passing the superroyalty rules. They will produce needless litigation, onerous compliance measures, and competitive impediments on American companies' ability to conduct trans-border transactions.

A White Paper issued to clarify the superroyalty provisions asserted that the "commensurate with income" standard applicable to foreign transfers of intangibles requires that periodic upward adjustments to royalties continue indefinitely into the future. Adjustments are mandated even if the arrangement was truly arms length when the contract was consummated. So if a U.S. multinational develops a new high-



Richard M. Hammer

"If foreign tax authorities refuse tax deductibility for superroyalty payments, double taxation will result. Time will tell, but all indications to date are that foreign authorities are not going to roll over and play dead. Some will refuse simply because superroyalties are a breach of the arms length principle."

shipped to U.S. distribution subsidiaries by foreign parents. This significant new deviation from the arms length standard would likely attract the attention of other nations. Earlier attempts to inject formulae into the transfer pricing process were more akin to facilitating the identification of an arms length transfer price, using what might be called a "rough cut approximation," rather than an overt attempt to reject the arms length standard.

The Tax Reform Act of 1986 (TRA'86) introduced the first major deviation from the arms length standard by adding the now infamous superroyalty provisions on intercompany transfer pricing on foreign transfers of intangible property rights. Unlike the earlier statutory formulary approach for profit allocation, the superroyalty provisions are subjective and, unfortunately, open-ended.

In a nutshell, superroyalty provisions require that payments on transfers of intangibles to related parties, either through the sale of an exclusive or non-exclusive license, must be "commensurate with the income attributable to the intangible." These deceptively simple words could be counter-

tech product, licenses it at arms length terms to foreign affiliates, and earns high profits because of foreign affiliates' efforts, the IRS would be free to increase royalty payments.

If foreign tax authorities refuse tax deductibility for superroyalty payments, double taxation will result. Time will tell, but all indications to date are that foreign authorities are not going to roll over and play dead. Some will refuse simply because superroyalties are a breach of the arms length principle. Such a scenario bodes especially ill for U.S. multinationals loaded down with excess foreign tax credits.

Shortcomings in the transfer pricing area epitomize congressional failure in the foreign tax area. The U.S. legislative focus appears to be primarily on generating revenue and closing tax loopholes. Such a myopic approach loses sight of the logical thread, the rhythm, that a sound tax policy and tax system require.

Richard M. Hammer, International Tax Partner, Price Waterhouse, is Chairman of the Tax Committee for the U.S. Council for International Business. This article is taken from his speech to the Foundation's international tax policy seminar September 25, 1990.

New Budget Raises Taxes Sharply; Hits States Unevenly

The new budget President Bush and congressional leaders have given the American people, touted as the grandest attempt at deficit reduction in history, will cost every man, woman, and child an average of \$664.68 in new taxes over the next five years. Put another way, the agreement plans to extract \$164.6 billion in extra revenue for the federal government by 1995.

The impact of the taxes will not be felt evenly from state to state (see map below). Many residents of states already paying among the highest per-capita federal tax burdens will have to fork over an even greater share. Connecticut, New Jersey, District of Columbia, and Massachusetts residents will face the largest per capita tax increases. While no state will escape unscathed, residents of Mississippi, Utah, and West Virginia will not be hit as hard. The additional per capita burdens range from a high of \$869.76 in Connecticut to

a low of \$499.88 in Mississippi.

Why will some states have to pay more? Income levels and consumption patterns are the determining factors, so demographics dictate how much of the extra tax burden each state will bear. With over 42 percent of the new revenue coming from high-income individuals, states with relatively high personal incomes will be hard hit by the following provisions:

- the new 31 percent top income tax rate;
- the increase in the alternative minimum tax rate to 24 percent;
- the raising of the Medicare wage cap from \$51,300 to \$125,000;
- phase-out of personal exemptions for taxpayers with adjusted gross incomes above \$100,000 (single taxpayer), \$125,000 (head of household), and \$150,000 (married, joint return);
- reduced itemized deductions (3 percent over \$100,000);

■ new 10 percent tax on luxury items.

The budget includes consumption taxes that generally hit low- and middle-income earners hardest. These will have a more dramatic impact on states with relatively low personal income levels. They include:

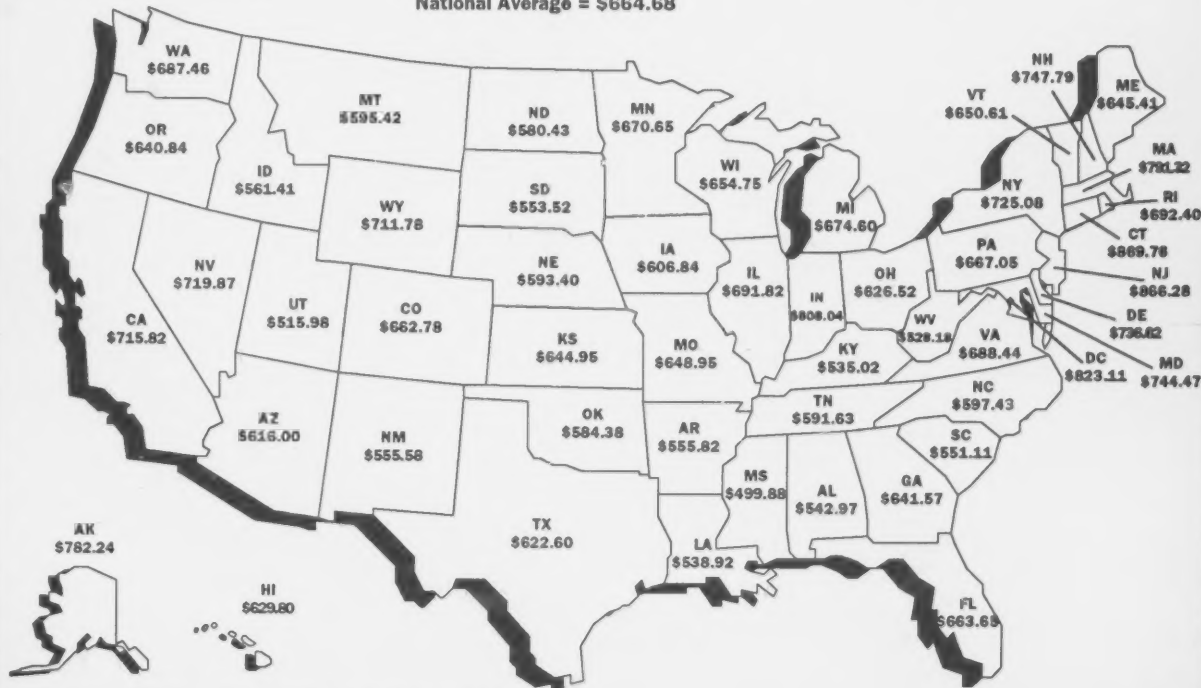
- the additional five cent per gallon motor fuel tax;
- the permanent extension of the telephone excise tax;
- the increase in the tobacco tax, an additional 8 cents by 1993;
- the increased taxes on beer, wine, and distilled spirits.

This year, the average American will spend 82 days working to pay his share of federal taxes. With \$164.6 billion in guaranteed tax increases over the next five years, every American will be working longer for Uncle Sam, but some states will be shouldering a disproportionate share of the load.

New Budget's Additional Burden to Per Capita Federal Tax Burden State by State

Fiscal Years 1991 - 1995

National Average = \$664.68



Source: Tax Foundation Federal Tax Burden by State model

Median Family Income from page 1

since 1981. The family's earnings are eroded even further by indirect federal taxes, such as excises, and state and local taxes not shown here, all of which have been increasing sharply. Significant gains for the median family had been achieved in the mid-'80s, when income rose an average of \$762 per year between 1982 and 1987.

The two-earner family that made \$29,627 in 1980 is now earning an estimated \$51,421. But this apparently hefty \$21,794 increase in the family paycheck over ten years was slashed by direct federal taxes and inflation to a net gain of only \$3,228. In other words, the sizable 73 percent nominal income gain the two-earner family has made since 1980 has been reduced to only a nine percent gain by direct federal taxes and inflation.

Federal Taxes

Since 1980, the federal income tax bill paid by the median family has risen 56.9 percent. As a percentage of the family's total income, the federal income tax claimed 13.7 percent of the family's total income in 1980, fell to a low of 11.8 percent in 1985, and rebounded to 12.4 percent in 1990.

The chunk that Social Security takes out of the typical family's income has increased more steadily. At \$3,934 in 1990, it is more than double the \$1,816 paid in 1980. Social Security will claim 7.6 percent of the family's 1990 earnings, up from 6.1 percent in 1980. Together, these two direct federal taxes will absorb 20 percent of family income, down only slightly from the 1981 peak of 20.3 percent.

Inflation

Rising inflation contributed to the decline in the typical family's purchasing power in 1990. Inflation stood at 13.5 percent in 1980 before declining steadily to a low of 1.9 percent in 1986, allowing the growth rate in family income to outpace inflation. Subsequently, however, inflation has accelerated and already has exceeded five percent in the first three quarters of 1990.

Proposed federal tax increases for FY1991, slowing of income growth, and the upswing in inflation do not bode well for the American family's purchasing power in the coming year.

See table at right for more detail on the plight of family income since 1980.

PRESIDENT'S MESSAGE

Average American Family Could Use a Break

In Lewis Carroll's *Through the Looking Glass*, Alice was told, "Now, here, you see, it takes all the running you can do to keep in the same place. If you want to get somewhere else, you must run at least twice as fast." Unfortunately, the predicament for America's median family in 1990 is even worse—as hard as the family has worked, taxes and inflation have thwarted its effort, lowering real income by \$614. And this does not even include the state and local taxes and federal excise taxes the family has to pay on top of that.

Not that salaries have fallen. Indeed, the median family's income before federal taxes and inflation will rise an estimated \$2,331 this year. But after higher income and Social Security taxes, along with rising inflation, that gain is just an illusion. The federal government has played its part in reducing the family's purchasing power by piling on higher taxes and simultaneously running up huge budget deficits that hinder economic growth.

Purchasing power's precipitous drop in 1990 is a bitter pill to swallow after a relatively prosperous decade for the median family. In the 1980s, 1981 was the only year that hurt family income more than this year, and aside from a slight downturn in 1988, every other year ended with greater family purchasing power. The mid-eighties were especially good, showing an average increase of \$762 per year from 1982 to 1987.

The average family cannot look to the new budget for help. Many new taxes are included, and unless the general economy picks up the pace substantially, 1991 is likely to tell the same sad story as 1990.

We have redefined the median family as two earners working full time the year round with two dependents. Until the '80s, the one-worker family was more representative of the workforce, but the proportion of American families with two earners has increased to almost 70 percent. The stark reality now is that it takes two workers running twice as fast to get anywhere in today's high-tax environment.



Wayne Gable

Median Family Income Before and After Direct Federal Taxes and Inflation

1980-1990

Year	Two-Earner Median Family Income ^a	Direct Federal Taxes			After-Tax Income	
		Income Tax ^b	Social Security	Total	Current Dollars	1990 Dollars ^c
1980	\$29,627	\$4,050	\$1,816	\$5,866	\$23,761	\$37,902
1981	32,224	4,386	2,143	6,529	25,695	37,155
1982	34,515	4,450	2,313	6,763	27,752	37,800
1983	36,106	4,300	2,419	6,719	29,387	38,781
1984	38,713	4,634	2,710	7,344	31,369	39,684
1985	40,593	4,787	2,862	7,649	32,944	40,243
1986	42,492	5,158	3,038	8,196	34,296	41,130
1987	44,536	5,291	3,184	8,475	36,061	41,724
1988	46,658	5,618	3,504	9,122	37,536	41,705
1989	49,090	6,022	3,687	9,709	39,381	41,744
1990 ^d	51,421	6,357	3,934	10,291	41,130	41,130

^a Median income for household with two earners employed full-time, year round.

^b Married couple filing joint return, two dependent children.

^c Adjusted by consumer price index, estimated 6% inflation in 1990.

^d Estimate.

Source: Tax Foundation; U.S. Department of Commerce, Bureau of the Census; U.S. Department of Labor, Bureau of Labor Statistics; U.S. Treasury Department, Internal Revenue Service.

Does the new FY1991 budget reconciliation plan provide a viable solution to the federal budget deficit problem without jeopardizing U.S. competitiveness?

Months late and under election pressure, Congress finally passed its budget over the last weekend in October. The stock and bond markets were unimpressed by the news, in spite of Fed easing. This was not surprising because the federal government will still be draining capital markets by over \$1 billion per day in new borrowing.

During the summit, the Bush administration went from "no new taxes" to "additional revenues in exchange for real spending cuts and budget process reform" to pretty much just more taxes. It was in many ways a repeat of recent slide-by summits, just with a higher price tag.

To avoid Gramm-Rudman's \$85 billion sequester, \$164.6 billion in new taxes were raised over the next five years. The much maligned bubble, which makes the code more progressive, was ironically used to promote "taxing the rich" and is now too politically convenient to give up. The so-called spending cuts do not take effect until FY 1993-94, after the 1992 elections—if in fact the cuts ever take place.

The Bush administration was faced with a choice: 1) negotiate a package with Congressional Democrats, reneging on the "no new taxes" pledge, or 2) veto appropriations bills, and force negotiations in the context of a Gramm-Rudman sequester. President Bush chose alternative 1. With the benefit of hindsight, it is hard to believe the political cost of the second course could have been greater.

"It was in many ways a repeat of recent slide-by summits, just with a higher price tag."

Of course, we do need to reduce the deficit. What has been forgotten is that it matters whether we do it by cutting spending or raising taxes. An excessive focus on deficits has caused us to lose sight of the real issue—economic growth.

In reviewing the drama of the 1991 budget, one is reminded of George S. Kaufman's comment: "I didn't like the play, but then I saw it under adverse circumstances—the curtain was up." Unfortunately, we may have to sit through many reruns. With the pledge broken and taxes raised once, we are now likely to face a series of annual tax increases to "reduce the deficit," that is, fill in behind spending growth as the government preempts a growing share of the nation's income.

It depends on whether Congress and the Administration adhere to the spending targets. If they won't do it now, what reason is there to think they will do it in the future?



William B. Modahl
Director of Tax Affairs
Digital Equipment

The most positive thing about the recent budget agreement is that "finally it's over for another year."

It's an historic first—a 5-year package of spending cuts and tax increases, which avoided further increases in corporate tax rates, avoided further burdens on private employee-benefit plans, and even avoided complicating an already bizarre set of foreign tax rules.

It helped level the global playing field slightly by imposing tax information return requirements on foreign firms doing business in America, much like the returns filed each year by American firms. But, it will certainly further confuse our competitive position by imposing the threat of harsh new tax penalties in an area already subject to much confusion, namely, inter-company pricing.

Unfortunately, there were also some ominous features to this budget process. A "new tax environment of the '90s" has previewed, with societal life-threatening "myths and red herrings."

Apparently some Americans still feel they have the right to benefit from government expenditures without sharing any increased costs—sort of a "new free lunch."

While Medicare recipients "demand" no increase in their costs (it was intended to be 50/50 co-pay from the start), the younger generation dutifully pays the highest social security tax in our history.

While more successful Americans are vilified on nightly TV for not paying enough tax (but Tax Foundation figures show that 46 percent of all income taxes are paid by the top 5 percent), the average American is featured as refusing to pay a few extra pennies in gas tax to help reduce the enormous federal debt he helped run up.

Although the recent package is a first step, my biggest worry is "what do we do next?" Our most urgent national fiscal issue is mustering enough social and political "spunk" to address the deficit crisis with "broad-based cures" that fairly and evenly distribute the "pain."

I firmly believe that under the leadership of George Bush, and with the cooperation of Congress, America can meet this challenge.



Albert E. Germain
Vice President, Taxes
ALCOA

Viewpoint brings concise opinions from experts in tax and fiscal policy to the readers of Tax Features on questions that are currently being debated by policymakers and the media. The opinions expressed are not necessarily those of the Tax Foundation. Editorial replies are encouraged.

Public Finance in Crisis:

Meeting the Challenge

Tax Foundation's 42nd National Conference and 53rd Annual Dinner

Wednesday, December 5, 1990 at The Waldorf-Astoria Hotel in New York City

Registration/Light Fare	12:30 p.m.	Astor Salon/Foyer
Conference Sessions	1:00 - 5:00 p.m.	Astor Salon
Reception & Dinner (Black tie optional)	6:00 p.m.	Palm Room/Starlight Room

- Direct any questions about the conference or dinner to Dixie Reding at 202-863-5454. FAX 202-488-8282.
- Reservations should be received by Wednesday, November 28, 1990.
- The Waldorf-Astoria is located at 301 Park Avenue, New York, NY 10022. Tel: 212-871-4534.

12:30 Registration (light fare)

1:00 Welcome: Wayne Gable
President, Tax Foundation

***The Ailing Federal Budget
Process: Is There a Cure?***

Issue Overview: Allen Schick
Professor of Public Policy
University of Maryland

Chairman: Alan Blinder
Gordon S. Rentschler Memorial
Professor of Economics
Princeton University

James C. Miller III
Director, OMB for President
Reagan, 1985 - 1988
Co-Chairman, Tax Foundation

David Stockman*
Director, OMB for President
Reagan, 1981 - 1985
Partner, The Blackstone Group

James McIntyre, Jr.
Director, OMB for President
Carter, 1977 - 1981
Partner, McNair Law Firm, P.A.

3:00 Coffee Break

3:15 ***Significant Trends in State
and Local Taxation***

Chairman: Haskell Edelstein
Senior Vice President and
General Tax Counsel
Citicorp/Citibank, U.S.A.

James W. Wetzler
Commissioner
New York Department of
Revenue and Finance

Benjamin F. Miller
Counsel, Multistate Tax Affairs
California Franchise Tax Board

David R. Francis
Business Editor
Christian Science Monitor

Thomas B. Joyce
Partner, Washington National
Tax Services
Price Waterhouse

5:00 Adjournment

**Not confirmed*

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Conference Fee: Member/\$100, Non-Member/\$125 Dinner/Reception: \$250

For the attendees listed, a check made payable to the **Tax Foundation** in the amount of \$_____ is enclosed.

Briefings in Los Angeles and San Francisco Bring Foundation's Message to West Coast



▲ From left to right at the headquarters of Occidental Petroleum in Los Angeles: Host Norman D. Alexander, Vice President - Corporate Affairs, Occidental Petroleum; Clayton J. LaForce, Dean, UCLA Graduate School of Business; Maureen Reagan; James C. Miller III, Co-Chairman, Tax Foundation; Paul C. Hebner, Executive Vice President, Occidental Petroleum; and Wayne Gable, President, Tax Foundation.



◀ From left to right at Occidental: Wayne Gable, President, Tax Foundation; Debra A. Gastler, Vice President - Taxes, Pacific Enterprises; and Anthony H. Buckman, Corporate Tax Manager, Toyota, U.S.A.

▶ In San Francisco: (L to r.) John J. Ross, General Tax Counsel, Chevron; James C. Miller III, Co-Chairman, Tax Foundation; and Martin R. Klitten, Vice President of Finance, Chevron.

Hosted by Chevron Corporation at the World Trade Club in San Francisco: (L to r.) J.P. LaCasse, Director of Taxes, American President Companies; Hugh Travaille, Vice President - Public Affairs, Pollack Corporation; Steven L. Rosner, Manager - Tax Accounting, Pacific Telesis Group; James C. Miller III, Co-Chairman, Tax Foundation; Glenn White, Co-Chairman, Tax Foundation Program Committee; and Christine Smith-Anello, Manager - Tax Planning, Levi Strauss & Co.



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See page 7 for information on the Tax Foundation's Annual Conference and Dinner December 5th at the Waldorf-Astoria Hotel in New York City

Tax Features

Packwood and Kanaga Receive Distinguished Service Awards; Address Simplification and Fairness

"In 1986, we were driven by one overriding desire," Senator Bob Packwood told the Tax Foundation's 53rd annual dinner in New York December 5th. "We wanted people to make investments from an economic standpoint."

Senator Packwood's speech followed the Tax Foundation's presentation to him of its Distinguished Service Award for contributions in the public sector and to William S. Kanaga, former chairman of Arthur Young & Co. for contributions in the private sector.

Mr. Kanaga's speech included several pointed remarks about the increasing complexity of the tax code and the federal budget. "The budget process has deteriorated to such an extent that we are all the more thankful to the Tax Foundation for taking a broad, educational, and thoughtful approach to the problem."

Senator Packwood made it clear that he sees tax simplification as a trade-off for fairness. "I'll tell you how to make it simple. At

See Annual Dinner on page 3



Tax Foundation

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Tax Foundation Co-Chairman James C. Miller III (L) presents Senator Bob Packwood the Distinguished Service Award for contributions in the public sector.

Foundation Enters 54th Year

The Foundation began 1990 with a survey of members' concerns in fiscal policy and built the year's programs around them. Simplicity, stability, and efficiency are the goals they set for tax policy, remote though they seem when one considers the current code. The Tax Foundation cannot steer the fiscal policy of government, but we can help keep those goals in sight.

Three special events which futhered these goals during the year also helped to keep our members in touch with Washington policymakers. A seminar on research and development tax policy in March featured the foremost congressional authority on the R&D tax credit, Rep. Beryl Anthony (D-AR). He addressed the nagging problem of the credit's annual expiration which prevents taxpayers from counting on the credit in their tax planning. This is one of many instances where the code's instability hurts the economy.

May's conference on tax and budget issues drove home the theme that the current level of taxation is higher than ever, both at the federal and state levels. More restraint on the spending side, not more tax revenue, is needed to reduce governmental deficits.

In September, as the media whipped up an anti-foreign frenzy, the Foundation held a seminar in which experts in international tax policy, including Representatives Hank Brown (R-CO) and Phil Crane (R-IL), debunked some of the myths about foreign investment. The Foundation's belief that there should be a free flow of goods and capital across borders was a major theme of the speakers.

Successful conferences were also held in Dallas and New York, and we will continue to bring the Foundation's message around the nation and even abroad during the coming year. But as long as Washington is the place where the bulk of America's tax dollars are sent and spent, the Foundation will be there to bring you the unvarnished facts and figures.



Wayne Gable



David L. Littmann

Sin Taxes Drive Up Federal Spending, Fail to Raise Predicted Revenue

For two reasons the tax package recently enacted in Washington must be viewed as self-serving, rather than in the national interest. First, many of the new taxes will cause the Consumer Price Index (CPI) to rise; yet Congress and nearly all other federal employees and their important constituents are effectively immunized against such price increases. Auto-

matic cost-of-living adjustments (COLA) in their pay and benefits are expressly designed to offset CPI increases.

Second, raising taxes, rather than controlling spending, postpones the day of reckoning when spending priorities must be established. Thus, elected officials avoid decisions that might risk their jobs or pensions; yet, these are critical decisions that households and private businesses must make all the time to remain solvent and competitive.

Let's examine 1990's sin tax package in greater detail. After all, the revenue expected from the so-called "sin" and excise tax hikes alone exceeds \$53 billion.

At first blush it might appear that only a few industries or individuals — those directly in harm's way — would suffer greatly from sin tax increases. But because items that now carry higher sin taxes are included in the U.S. Labor Department's monthly survey of prices, higher sin taxes and other excise taxes drive the CPI higher as well. Those whose wages and benefits are tied to the CPI by COLA clauses (e.g., government workers, retirees, social security recipients and veterans) are effectively exempted (partially or wholly) from the result of these tax increases.

The accompanying table examines the cumulative effect of legislated COLA increases since 1970 compared to annual percentage gains in U.S. per capita personal income. One dollar in 1970, bolstered by 20 COLA add-ons becomes worth \$4.38 as of January 1991. These COLA boosts nearly equal the entire \$4.84 nominal income gains realized during this period by the average American. To the extent the real incidence of sin and excise taxes is shifted to non-COLA'd workers and consumers, the tax code becomes less equitable and more highly skewed in favor of government employees and those receiving direct benefits from Washington.

In addition to the equity and ethical issues of sin and excise taxes, there is economic perversity as well. Some 30 percent of federal outlays — \$400 billion

— is tied to the CPI. Raising tobacco, alcohol, airplane, gasoline, and (extending) telephone taxes actually drives up federal spending. Looking only at the 5 cent per gallon hike in the gasoline tax, for example, it might appear that \$5 billion per

"Raising tobacco, alcohol, airplane, gasoline, and (extending) telephone taxes actually drives up federal spending."

year would be generated for Uncle Sam's coffers. But that 5 cent hike translates into a 5 percent increase in the pre-Kuwait pump price of gasoline. "Motor fuels" gets a 3.3 percent weight in the CPI, so a 5 percent jump in gas prices translates into a 0.2 percentage point increase in CPI. Funneled through the federal government's COLA clauses, those 0.2 percentage points would add between \$800 million and \$1 billion to overall federal spending. Hikes in other sin taxes push the CPI higher still, causing higher COLAs and greatly reducing net revenue gains.

Also, lawmakers have chosen to offset the regressive effects of higher excise taxes by granting low income people tax credits or lower income tax rates. Ironically, the true cost of the tax hikes will be greater than suggested by initial revenue estimates, but the net revenue to Uncle Sam will be less.

Typically, sin taxes fail to raise as much revenue as projected. For example, excise taxes on cigarettes were doubled in 1982. Revenue from tobacco taxes (99.1 percent of which comes from cigarettes) jumped as predicted at first, from \$2.58 billion in FY1981 to \$4.66 billion by FY1984. But as consumers cut back their cigarette use, and as the black market in untaxed cigarettes grew, tobacco revenues contracted. By FY1989, tobacco tax revenues had slumped to \$4.29 billion. Simply put, excise taxes are not a reliable revenue raiser.

As many studies have shown, new tax revenues merely accelerate the growth rate of federal spending, making deficit reduction even more remote. How else could record revenue gains — averaging \$63 billion annually over the longest peacetime expansion the U.S. has ever enjoyed coincide with worsening deficits? Washington continues to shelter its own budget sins by levying more sin taxes. In the process it is worsening the performance of the private sector and shifting tax burdens increasingly toward private sector employees and citizens who do not receive federal benefits.

COLA Increases vs. Percent Changes In U.S. Per Capita Personal Income

1969 - 1990s

Year	U.S. Per Capita Personal Income	Percentage Change	COLA
1969	\$3,809		
1970	4,051	6.35%	15.0%
1971	4,296	6.05	10.0
1972	4,664	8.57	20.0
1973	5,181	11.08	.0
1974	5,644	8.94	11.0
1975	6,073	7.60	8.0
1976	6,651	9.52	6.4
1977	7,294	9.67	5.9
1978	8,136	11.54	6.5
1979	9,033	11.03	9.9
1980	9,919	9.81	14.3
1981	10,949	10.38	11.2
1982	11,480	4.85	7.4
1983	12,096	5.38	3.5
1984	13,114	8.40	3.5
1985	13,896	5.96	3.1
1986	14,596	5.04	1.3
1987	15,423	5.67	4.2
1988	16,513	7.07	4.0
1989	17,596	6.56	4.7
1990s	18,432	4.75	5.4

Sources: Department of Commerce, Bureau of Economic Analysis; Department of Labor, Bureau of Labor Statistics.

David L. Littmann is first vice president and senior economist with Manufacturers National Bank of Detroit, a member of the Tax Foundation since 1948.



Senator Bob Packwood (R-OR), Distinguished Service Award recipient for contributions in the public sector.



Tax Foundation Co-Chairman James Q. Riordan (r.) presents William S. Kanaga the Distinguished Service Award for contributions in the private sector.



Senator Bob Packwood (L) chats with the Honorable Harry F. Byrd, Jr., a former recipient. In his remarks, Senator Packwood said that along with Senator Russell Long, Senator Byrd had taught him more than anybody in Washington.

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about a 16 percent tax rate, if you tax fringe benefits at full value and social security at about 85 percent, we'd have a simple code. No deductions, of course, for charitable contributions to your university or hospital, no excess medical deductions, no state or local income tax deductions — a straight flat tax — 16 percent. . . . If you're a single mother of two working at Woolworths making \$14,000 gross, you're going to pay

"In 1986, we were driven by one overriding desire. We wanted people to make investments from an economic standpoint."

— Senator Bob Packwood

\$2,240 in taxes. Would that be fair? My hunch would be that most people in this room tonight would say that isn't fair."

The senator addressed the subject of taxing the rich by first pointing out that no one considers himself to be rich. But taking \$100,000 in annual income as a benchmark of wealth, the senator pointed out that no tax on this group can raise enough money to spare society at large the lion's share of the tax burden. "There simply aren't enough of them. . . . Today the top one percent of

all the taxpayers in this country pay about \$150 billion a year. That covers roughly the lower echelon of medicare programs, medicaid, food stamps — roughly the rich are paying for the poor."

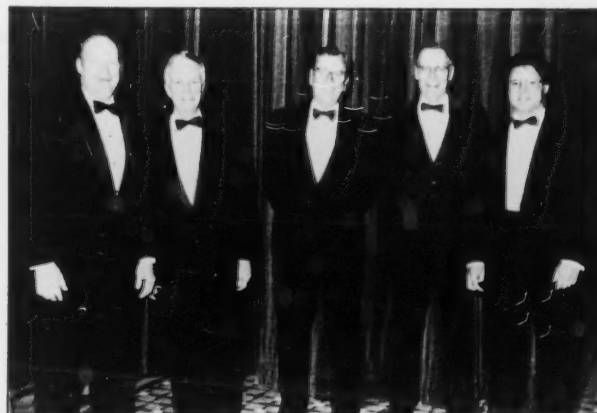
The Oregon Republican closed with a more general consideration of fairness in taxation — just what percentage of a citizen's income



William S. Kanaga, former chairman of Arthur Young & Co. and recipient of the Distinguished Service Award for contributions in the private sector.

should be taxed, at the very most? He wants Americans to think about that issue because the overall portion of American taxpayers' income spent by government has steadily increased. "In 1950, total taxes, federal, state and local, equaled about 21 percent of GNP, and we spent about 23 percent of GNP — we had a deficit. Thirty-five years later, federal, state, and local taxes take about 30 percent of GNP, and we spend about 32 percent.

"The question is, do we want to become a nation like Denmark or Sweden which tax over 50 percent of GNP? As for me, I'd prefer to be America."



From left to right: James C. Miller III, co-chairman of the Tax Foundation; award recipients Senator Bob Packwood (R-OR) and William S. Kanaga; James Q. Riordan, co-chairman of the Tax Foundation; and Wayne Gable, president of the Tax Foundation.

Tax Foundation's 42nd Annual Conference Addresses Federal and State Budget Woes

The Tax Foundation held its 42nd annual conference in New York City the afternoon of December 5. Corporate executives, professors and students of economics and public finance, and members of the business press heard presentations from experts on the budgetary problems of federal and state government.

Federal Budget Ills

"The Ailing Federal Budget Process — Is There a Cure?" served as the theme of the first panel discussion. The subject was addressed first by Allen Schick, Professor of Public Policy, University of Maryland; and Alan Abramson, Research Associate, Urban Institute.

Alan Blinder, Gordon S. Rentschler Memorial Professor of Economics, Princeton University, moderated the panel and highlighted the complexity of the federal budget process in his introduction. "The budget process at the Federal level in this country is so complicated now that it looks like the tax forms that

to IRS reestimates, S&L costs, Persian Gulf expenditures, and other factors without triggering a sequester, "it looks like the deficit has been defanged of its budgetary teeth."

An important political reason for our budgetary woes is 'divided government,' according to Schick. "Democrats

"What we got in the 1990 budget deal was the largest tax increase in history, taxes that go on the books and that will remain there forever unless Congress takes them off."

— James C. Miller III

have a lock on Congress, the Republicans on the White House. Divided government has become institutionalized and it turns out that one of the things that divides government between Democrats and Republicans is the budget itself. . . . Should it be any surprise that if the government is divided on the issue of the budget, that the humpty-dumpty of government cannot put itself together for a consistent course of action for deficit reduction."

Alan Abramson of the Urban Institute followed Schick's remarks with views that were considerably more optimistic about the recent budget package and prospects for the new budget process's ability to control the deficit. "In contrast to some of the recent budget summit agreements, I think this year's package is longer on real deficit reduction and shorter on smoke and mirrors. A realistic projection, I think, would see the deficit, outside of the bail-out, shrinking from this year's three percent of GNP level down to one percent."

One definitely negative result Abramson noted was an echo of Blinder's introductory remark on the complexity of the budget process. "Under the new budget plan, we have 'discretionary caps,' 'pay-as-you-go' for entitlements and revenues, 'fire walls'

around social security, 'look-back' procedures to guard against non-essential supplemental appropriations. . . . There is no constituency for making budgeting simpler, and the cost of having an incredibly complicated budget process is not only a bewildered public. The budget process is more open to gimmickry and manipulation by those who can exploit the loopholes that will inevitably be discovered."

Blinder then introduced two former Directors of the Office of Management and Budget, James McIntyre, Jr., OMB Director for President Carter, 1977-80, and currently a partner in the McNair Law Firm

in Washington, DC; and James C. Miller III, OMB Director for President Reagan, 1985-88, and currently chairman of Citizens for a Sound Economy and co-chairman of the Tax Foundation.

McIntyre opened with a salvo directed at Abramson and Schick who had both expressed their hopes for a falling deficit, but not necessarily a balanced budget. "I hear people say the deficit is not all that bad. Well, I will tell you, \$327 billion dollars bothers me. As a budget director, sixty billion dollars bothered me. I was involved in the first summit in 1980, and we used a reconciliation process to try to get a \$16.5 billion deficit down to zero. Now we are talking about \$327 billion, and for the record, I think that is an unacceptably high level."

He went on to say that budgetary manipulations will never bring the deficit under control because the budget is a



Alan Abramson
Research Associate
Urban Institute



Former Directors of the Office of Management and Budget: James McIntyre, Jr. (l.) served President Carter 1977-1980; James C. Miller III (r.), current co-chairman of the Tax Foundation, served President Reagan 1985-1988.

I have to fill out every April. There are actually nine different possible sequesters, and of course the same kind can occur more than once."

Allen Schick began by explaining, "What the budget summit and Gramm-Rudman III did is to change the thrust of Gramm-Rudman from control of the deficit to control of spending levels." Because the deficit can be adjusted due



Allen Schick
Prof. of Public Policy
Univ. of Maryland

political process. "When the deficit becomes a problem that gets enough people's attention, what do they do? They change the process. The fact of the matter is that only tough decisions made by our President and by our Congressmen will reduce the size of the national deficit."

James C. Miller III spoke next and issued his prognosis of the federal government's budgetary ills. "First, the federal government's command over resources is truly excessive. Second, our tax code, despite recent progress, is far more complicated and inhibiting of economic growth than it needs to be. Third, federal spending is not only growing at excessive rates, but the composition of that spending reflects the happenstance of the moment, not a well thought out establishment of priorities. Finally, there is our addiction to deficit finance."

The recent budget package would certainly not number among the cures Miller might recommend. "If anything, it made the situation worse because it will prolong the illness. What we got in the 1990 budget deal was the largest tax increase in history, taxes that go on the books and that will remain there forever unless Congress takes them off. Secondly, a gigantic increase in federal spending, over \$100 billion in this 'year of austerity,' total spending goes up by over \$100 billion, despite all the rhetoric about the cuts. And we have the promise of spending restraint in the

out years. I say promise because I don't view the bonded enforcement package as workable."

On Miller's list of remedies are some truth-in-budgeting reforms such as scrapping the current services budget and acknowledging all



Hashell Edelstein
Senior Vice President
and General Tax
Counsel
Citicorp/Citibank, N.A.

of government's financial liabilities in the budget. More specifically, in the defense area, Miller asserts there are some savings to be had, especially by more competitive procurement, multi-year budgeting, and, "preventing Congressmen's use of defense budget

as fodder for their reelection campaign."

Among many concrete suggestions for cuts in federal spending, Miller included further means-testing on social security, eliminating the Interstate Commerce Commission, privatizing the U.S. Postal Service and cutting out the Amtrak subsidy.

State Budget Issues

"Significant Trends in State and Local Taxation" was the theme of the late afternoon panel. Haskell Edelstein, Senior Vice President and General Tax Counsel, Citicorp/Citibank, N.A., moderated the panel which included James W. Wetzler, Commissioner, New York Department of Revenue and Finance; Benjamin F. Miller, Counsel, Multistate Tax Affairs, California Franchise Tax Board; David Francis, Business Editor, *Christian Science Monitor*; and Thomas B. Joyce, Partner, Washington National Tax Services, Price Waterhouse.

James Wetzler conveyed the concern over keeping states' taxation in balance with its services. "Any state whose taxes greatly exceed the services that are being provided faces the risk that individuals and businesses are going

to pick up and go somewhere else. His presentation explained how New York's franchise tax tends to have very volatile revenue yields. Unfortunately, with revenue volatility, when you get more revenue, the governor or the legislature tend to spend it. Once those spending



Benjamin F. Miller
Counsel, Multistate
Tax Affairs
California Franchise
Tax Board

programs are in place, they are hard to reduce when the volatility surfaces and the revenues decline."

Benjamin Miller explained that state tax policies are becoming even more complex. Tax policies are not set just by the legislature or the governor or even by the tax boards. Now, tax policy is to a large extent influenced by court decisions.

David Francis predicted that the budget crisis in Massachusetts is not likely to go away very soon with spending still growing much faster than reve-

nues. He suggested that the state's budget deficit situation is not too different from the federal government's predicament by comparing the state's constitutional requirement for a balanced budget with the federal government's Gramm-Rudman deficit reduction law. Unfortunately, both state and federal revenues have been overestimated while spending growth has gone unchecked.



Thomas B. Joyce
Partner, Washington
National Tax
Services
Price Waterhouse

See Annual Conference on page 8

The generosity of the following firms made our annual conference and dinner possible.

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Xerox Corporation

College Classroom Project Continues to Bridge Gap Between School and Business World

The Tax Foundation gives advanced students of business, accounting, economics, and finance a glimpse of American business's concern with taxation by treating them to the annual conference in New York City as part of the "College Classroom Project."

Reports from the over 75 students were uniformly positive as they mingled with senior executives from companies they hope to find employment with in the near future.

The generosity of the following companies enabled more students than ever to participate in this year's project:

American President Companies, Ltd.
AT&T
Brooklyn Union Gas Company
Cantor Fitzgerald Securities Corp.
Chevron Corporation
Hallmark Cards, Inc.
International Minerals and Chemical Corporation

Johnson & Johnson
Masco Building Products Corporation
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Monsanto Company
Norfolk Shipbuilding & Drydock Corp.
Occidental Petroleum Corporation
P.H. Glatfelter Co.
Philadelphia National Bank
UNUM Corporation
Weyerhaeuser Company
World Publishing Company



Dan Witt, vice president of the Tax Foundation at left, and Michael Ambler, General Tax Counsel, Texaco at right, pose with two students attending the conference.



Cadets from SUNY Maritime are joined by Gwain Gillespie, Executive Vice President - Finance & Administration, UNUM Corporation.

Summary of Revenue-Raising Provisions of H.R. 5835 (OBRA '90)

Tax Provision	Effective Date	Revenue FY1991-95 (\$Millions)
Income/Employment Taxes		
1. Eliminate 33% "bubble" rate for individual income tax; replace with 31% marginal rate for all income above previous "bubble" threshold; maximum tax on capital gains 28%.	1/1/91	\$11,234
2. Phase out personal exemption on adjusted gross income (AGI) above \$100,000 - single; \$125,000 - head of household; \$150,000 - married (joint).	1/1/91	\$10,764
3. Limit itemized deductions on AGI over \$100,000	1/1/91	\$17,904
4. Eliminate medical deduction for cosmetic surgery.	1/1/91	\$269
5. Extend Social Security payroll tax to State/Local employees without employer pension plan.	7/1/91	\$9,187
6. Increase Medicare payroll tax cap to \$125,000.	1/1/91	\$26,881
Excise Taxes		
1. Increase motor fuels excise taxes.	12/1/90	\$25,039
2. Double "gas guzzler" tax.	1/1/91	\$385
3. Increase tobacco taxes in 1991 and 1993.	1/1/91	\$5,876
4. Increase alcohol excise taxes.	1/1/91	\$8,768
5. Impose 10% tax on autos, boats, airplanes and other luxury items.	1/1/91	\$1,479
6. Extend Leaking Underground Storage Tank (LUST) tax.	12/1/90	\$594
7. Increase/extend Airport Trust Fund Excise taxes.	12/1/90	\$11,908

Tax Provision	Effective Date	Revenue FY1991-95 (\$Millions)
8. Extend Federal telephone excise tax.	1/1/91	\$13,069
Business/Miscellaneous Taxes		
1. Revise treatment of insurance company losses and salvage values.	1/1/90	\$581
2. Require insurance companies to amortize deferred acquisition costs.	9/30/90	\$7,995
3. Various tax compliance provisions.	3/20/90	\$298
4. Increase reversion tax on retiree health reversions.*		\$949
5. Raise interest rate on corporate tax underpayments.	1/1/91	\$1,826
6. Expand ozone-depleting chemicals tax.*	1/1/91	\$485
7. Increase Harbor Maintenance tax.*	1/1/91	\$1,842
8. Other corporate tax provisions.	10/10/90	\$1,342
9. Extend IRS fees for issuing private tax opinions.	9/30/90	\$225
10. Extend Federal unemployment .2% surtax.	1/1/91	\$5,396
11. Extend IRS collection limitation from 6 to 10 years.	1/1/91	\$8
12. Revise treatment of U.S. beneficiaries of foreign trusts.		\$297
Total Revenue-Raising Provisions		\$164,600
*Treated as business tax.		



Lelf H. Olsen

Capital Gains Tax: A Sales Tax on our Nation's Savings

If you tuned in to the evening news any time during the recent budget battle, you may have heard a member of Congress speak out against higher gasoline taxes. He may have said they were unfair and would hurt the economy. The gasoline tax is, of course, a sales tax.

Five minutes later you might have heard that same member of

Congress speak in opposition to a lower capital gains tax because it would favor the rich and that was unfair. But the capital gains tax is also a sales tax, so why doesn't the same argument apply?

Capital is thought to be largely owned by the rich so that a reduction in the capital gains tax would favor only this group. On the contrary, a great many Americans own capital assets and realize capital gains through the sale of homes, investing the proceeds partly in a less costly home and partly in interest and dividend yielding assets. As a result, income tax revenues go up. It is true, of course, that capital ownership is concentrated among a relatively small number of Americans, and they are rich relative to most Americans. So what's wrong with taxing them to the limit? They account for few votes. That is exactly what many members of Congress say publicly, and it sells with a great many Americans.

Here's what is wrong with that reasoning. During the past year Americans have rejoiced over the removal of the Berlin Wall and the general collapse of centrally planned, communist economies in Eastern Europe and the Soviet Union. Americans look on these events as the victory of our economic system over those of communism.

The key distinction between these command economies and ours is that capital is owned by government in communist countries while in the U.S. it is privately owned. You might say that in the communist-socialist economies capital gains are taxed at a 100 percent rate, since they are simply not permitted.

"We should worry less about who owns the nation's savings and more about how well it is managed."

After all, since the capital was owned by "the people's government," presumably its management served the best interests of the people and not just the rich. That presumption was wrong: not only is their machinery and equipment obsolete and technology outdated, but the environment has been severely polluted. What should we conclude from this example? We should worry less about who owns the nation's savings and more about how well it is managed. As a 1985 Treasury Department study of the capital gains tax put it:

"In an economic system placing a high value on free choice and consumer sovereignty, blocking or impeding voluntary

exchanges or limiting competition causes a loss of economic efficiency by preventing transactions from which both parties gain. In the absence of significant externalities, economic efficiency is reduced by disallowing such transactions or by imposing costs that make the price paid by buyers differ from the price received by sellers."

That is exactly what the capital gains tax does. Since virtually all capital gains are reinvested in another asset, the seller is left with less to invest, build businesses, and create jobs. It doesn't help the tax base either because less investment means less income to be taxed.

The higher the tax, the greater the hindrance to individual choice. The Congressional Budget Office said in 1988: "The statistical results offer additional support for the view that higher tax rates do lower realizations of capital gains. As a result, increases in tax rates on capital gains produce much less

"The more efficiently the nation's privately owned capital is managed, the stronger is the income tax base, through employment, growth and income on all levels."

revenue than they would if taxpayers' behavior were unaffected." This tells us that people make a conscious decision to immobilize their savings because of that tax. There are other unanswered questions. If capital management decisions are interfered with by the capital gains tax, what does this do to the accumulation of savings and the increase in wealth? What does it do to the growth of income over time which feeds the income tax revenues of the federal government?

The issue of "fairness" creates illusions. It implies that wealthy people buy a richer lifestyle through capital gains, taxed at a lower rate than income. That is not true. People do not typically live off a stream of capital gains. But if their management decisions are not distorted by capital gains taxes, they will cause their capital to grow in value and to generate more income in time. That income is taxed at a progressively higher rate. In fact, the more efficiently the nation's privately owned capital is managed, the stronger is the income tax base, through employment, growth and income on all levels.

Americans acknowledge that our market economy with privately owned capital is superior to that of communism. Yet we contradict that acknowledgment with political rhetoric. People who own or manage capital, those who have become rich creating jobs, or in entertaining people in sports and the theater, are forced to defend their economic legitimacy in a political system that presumably extols private ownership of capital. They are treated derisively and with hostility in public political debate. Our political system has and will continue to manage that contradiction. But when it is translated into public policy, we should all ask whether we are being led to play a damaging game with the nation's privately owned savings. Are we all going to be poorer in the long run as our economy fails to perform as well as it could?

Lelf H. Olsen, former chief economist for Citibank, now heads Lelf H. Olsen Investments, Inc. in New Canaan, Connecticut.

Annual Conference from page 5

Thomas Joyce pointed out the similarities between state and international taxation. In both cases cross-border taxes are levied, involving separate governments with different, independent tax and spending authorities. The growing level of international trade and the rapidly changing federal international tax rules cannot help but impact states in their decision-making process. If the federal code allocates income away from a U.S. corporation subject to state tax, then the state loses that taxable pool of income as well.

For proceedings of the conference, please contact the Foundation.

Tax Features

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From left: Tax Foundation President Wayne Gable; George B. Erensen, Vice President - Taxes, Olin Corp.; Frank J. Blanca, Vice President, Taxes, American Brands, Inc.; and Gerald K. Howard, General Tax Counsel, GTE Corp.



Tax Foundation Co-Chairman James C. Miller III (L) with Robert L. Plancher, Senior Vice President and Chief Accounting Officer, American Brands, Inc.

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Tax Features

Foundation Leads International Tax Delegation to Europe

Meet with U.S. Treaty Partners to Discuss Impact of U.S. Policies

At presstime senior staff of the Tax Foundation are heading a delegation from the U.S. to the UK, Belgium, France and Germany for a series of international tax conferences and briefings on the impact of U.S. tax policy on U.S. treaty partners. The delegation includes members of the staffs of the House Ways and Means Committee and the Senate Finance Committee who are meeting with foreign treasury officials and tax policy makers in London, Brussels, Paris and Bonn.

Among our treaty partners' representatives will be UK Inland Revenue officials Richard Pratt, Head of European Community and International Trade Issues; Peter Fawcett, International Division - Policies; and Ian N. Hunter, International Division - Technical. In Brussels, Willy de Clercq, Chairman of the External Relations Committee in the European Parliament, is a featured speaker, and a meeting is being held with Christiane Scrivener, Commissionaire for Taxation in the European Commission.

The challenge facing fiscal authorities around the world today is daunting: how to fashion and administer a tax policy that takes into account not only traditional domestic concepts of equitable taxation, but those of other nations as well. Since tax treaties are the fundamental tool available for moving toward consensus on tax treatment of multinational corporations, the Foundation is promoting mutual understanding among fiscal authorities by hosting this series of conferences.

The events are part of the Foundation's international tax assessment project. This ongoing program of studies, reports, and conferences is designed to inform tax policy makers and business leaders on international taxation. Specifically, the focus is on the consequences of tax provisions affecting the foreign affiliates of U.S.-based companies and the U.S. affiliates of foreign-based companies.

FRONT BURNER

Spending Restraint Gets Short Straw in New House Rule



Wayne Gable
President,
Tax Foundation

As federal tax policy has more and more become an exercise in revenue raising, professional

revenue estimators have found themselves blinking in an unaccustomed spotlight.

On January 3, the first day of the new Congress, that spotlight intensified. The House of Representatives passed an unfortunate rule declaring the Congressional Budget Office (CBO) to be the official revenue estimating agency, or "scorekeeper," for pay-as-you-go spending legislation instead of the Office of Management and Budget (OMB).

My general feeling is that estimators on both ends of Pennsylvania Avenue do a professional job. They are more concerned with econometric modeling and microsimulation than with politics. But there is no doubt that the assignment of official estimating responsibility to OMB in the budget negotiation was an important concession to the President's desire to hold down congressional spending. When it comes to pay-as-you-go, "OMB is more concerned about the paying than the going," as Rep. Silvio Conte (R-MA) said during the floor debate.

What is pay-as-you-go, and why is the House of Representatives so dead set against having OMB do the scorekeeping? As part of last year's Omnibus Budget Reconciliation Act of 1990 (OBRA), any bill which will cut taxes or increase entitlement spending must be accompanied by a provision which, according to an official estimate supplied by OMB, "pays" for the decreased tax or increased entitlement, either by cutting a different entitlement or by raising revenue elsewhere. Ways and Means Committee Chairman Dan Rostenkowski (D-IL) claims the new rule will

See Gable on page 6



Tax Foundation

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Washington's Largest Monument: The National Debt

It is certainly not a happy new year for government finance in America. A whopping \$3.33 trillion national debt, nearly quadruple its 1980 level, represents a \$13,298 debt for every man, woman, and child in the U.S.

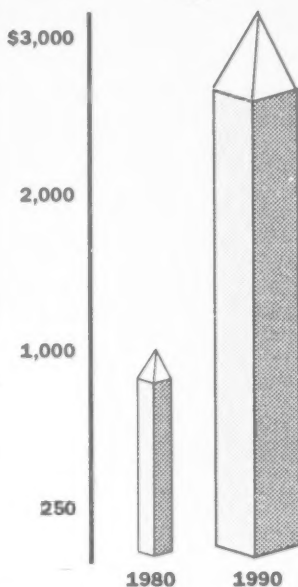
Anticipating higher indebtedness in the coming year, the federal government has raised its 1991 debt ceiling to a record \$4.14 trillion. Even this \$810 billion increase in the legal limit may not be adequate as we quickly approach this ceiling. The culprit is faster government spending, especially higher interest payments, the growing cost of the savings and loan bailout, the estimated \$30 billion cost of Operation Desert Shield and \$50 billion in lost federal revenue due to the recession.

The Statutory Debt Limit

The debt limit, or debt ceiling, is an amount written into law as a legal limit to the federal government's indebtedness. It was revised an average of 2.3 times per year in the eighties, four times in 1987 alone for a total of \$500 billion, the largest annual increase of the eighties. Of the decade's 21 increases, ten were quick solutions, after the federal government had surpassed its spending authority.

Growth of the National Debt in the 1980s

(\$Billions)



Source: Tax Foundation

The Deficit and the Debt

The trend of our national debt from 1940 to 1980 showed a increase of nearly \$21.5 billion a year, a troublesome rate of increase to budget officials at the time. But in the last decade, the debt has skyrocketed. In 1980 it stood at just over \$900 billion, but by 1985 it had doubled to over \$1.8 trillion. Far from slackening in the second half of the decade, the debt grew to \$2.8 trillion over the next four years.

Interest Cost of the Debt

Interest payments on our debt continue to climb steadily as our annual deficits pile up. Payment of interest on the debt is currently the third largest federal government expenditure, following income security and defense. For fiscal year 1991, the estimated annual interest on the public debt is \$259 billion, \$29 million for every hour of the day, or \$495,580 dollars per minute.

The net interest (interest paid out minus interest received) has even risen as a percentage of total outlays, despite rising total outlays. From 1955 to 1975, the percentage hovered around 7.3 percent. During the eighties, it shot up from 8.9 percent to 14.8 percent of outlays. See table below for detail.

Trends in Federal Debt, Deficits, and Related Measures

Selected Fiscal Years 1940-1989

(\$Billions Except Per Capita)

Year	Debt Outstanding (a)			Net Interest				Deficit	
	Total	Per Capita	% of GNP	Total	Per Capita	% of Outlays	% of GNP	Total	% of GNP
1940	\$ 50.7	\$ 381	52.9%	\$.9	\$ 7	9.5%	.9%	-\$2.9	-3.0%
1945	260.1	1,959	122.5	3.9	28	3.4	1.5	-47.6	-22.4
1950	256.9	1,687	96.3	4.8	32	11.3	1.8	-3.1	-1.2
1955	274.4	1,654	71.0	4.9	30	7.1	1.3	-3.0	-0.8
1960	290.5	1,608	57.3	6.9	38	7.5	1.4	-	-
1965	322.3	1,659	47.9	8.6	44	7.3	1.3	-1.4	-0.2
1970	380.9	1,858	38.5	14.4	70	7.4	1.5	-2.8	-0.3
1975	541.9	2,509	35.6	23.2	107	7.0	1.5	-53.2	-3.5
1980	908.5	3,989	34.0	52.5	231	8.9	2.0	-73.8	-2.8
1981	994.3	4,320	33.3	68.7	299	10.1	2.3	-78.8	-2.8
1982	1,136.8	4,889	36.2	85.0	366	11.4	2.7	-127.9	-4.1
1983	1,371.2	5,840	41.3	89.8	382	11.1	2.7	-207.8	-6.3
1984	1,564.1	6,600	42.4	111.1	489	13.0	3.0	-185.3	-5.0
1985	1,827.5	7,638	46.2	129.4	541	13.7	3.3	-212.3	-5.4
1986	2,129.5	8,776	50.9	136.0	560	13.7	3.3	-221.2	-5.3
1987	2,354.3	9,609	53.1	138.6	566	13.8	3.1	-149.7	-3.4
1988	2,614.6	10,567	54.6	151.7	613	14.3	3.2	-155.1	-3.2
1989	2,881.1	11,528	55.9	169.1	677	14.8	3.3	-151.9	-2.9
1990	3,330.7	13,298	61.6	183.8	734	14.7	3.4	-220.4	-4.1

(a) End of fiscal year.

Sources: Treasury Department; Office of Management and Budget; House Budget Committee; and Tax Foundation computations.

1990: A Brief Review of the Year in Tax Policy

After an agonizing exercise in budget summity, the federal government closed 1990 with a \$220.4 billion deficit, this despite FY90 revenues topping \$1.03 trillion, a 4.1 percent increase from FY89. The growing deficit prompted Congress and the Bush Administration to pass the Omnibus Budget Reconciliation Act of 1990 (OBRA), allegedly the grandest attempt at deficit reduction in history. In fact, disputes over the budget deficit overshadowed every significant piece of tax legislation during 1990.

The year began with two major budget issues at the top of the agenda: the placement of the Social Security

"Disputes over the budget deficit overshadowed every significant piece of tax legislation during 1990."

trust funds off budget and a reduction of the capital-gains tax rate. Senator Moynihan (D-NY) proposed that the Social Security tax be reduced to equal the level of outgoing benefits, a "pay-as-you-go" system. This change was intended principally to accomplish two tasks: reduce taxes for the income class hardest hit by payroll "contributions"; and to prevent Social Security "surpluses" from hiding the true size of the budget deficit. Although the Social Security trust funds are currently off budget, Moynihan's proposal to cut the rate was unsuccessful.

The Bush Administration's most notable initiative in 1990 was its push for a cut in the capital gains tax rate. While the Joint Committee on Taxation predicted the lower rate would drain \$11.4 billion from anticipated federal revenue, the Treasury Department insisted that the proposal would raise \$12.5 billion in new revenue. The entire debate did not occur at this professional level, however. Many legislators used the issue to campaign against "the rich" who they alleged to be the only beneficiaries of a preferential rate on capital gains.

Unable to come to any agreements, the President and congressional lead-

ers convened a budget summit. With President Bush abandoning his promise of "No New Taxes," both parties agreed to increased tax revenues, yet neither Bush nor congressional leaders wished to take credit for bringing specific new taxes to the negotiating table. As the summit continued and Congress left for summer recess, lawmakers backed themselves against a wall with a mounting deficit, a government shutdown, and numerous continuing resolutions.

Due to Congress' inability to pass a budget by the end of the fiscal year, the government was forced to shut down for three days. Congress did succeed, however, in dodging the \$150 billion sequester required by the Gramm-Rudman-Hollings Act. During negotiations, Congress increased the statutory debt limit six times, with the debt finally reaching \$3.3 trillion. (See article on page 3.)

The President signed OBRA into law on October 27, and as in previous budget summits, the compromise which emerged instituted higher taxes and promised spending cuts to reduce the deficit. The Act's proponents promise it will trim the deficit by \$496 billion over five years. Its \$164.6 billion in revenue raising provisions are estimated to cost an average of \$664.68 per capita in new taxes over the next five years. The provisions of the new budget which raise the most new revenue include:

- a new 31 percent top marginal rate;
- increase in the individual alternative minimum tax rate to 24 percent;
- raising the Medicare wage cap from \$51,300 to \$125,000;
- phase-out of personal exemptions for taxpayers with adjusted gross incomes above \$100,000 (single taxpayer), \$125,000 (head of household), and \$150,000 (married, joint return);
- new 10 percent tax on luxury items;
- additional five cents per gallon motor fuel tax;
- permanent extension of the telephone excise tax;
- increase in the tobacco tax, an additional 8 cents by 1993;
- increased taxes on beer, wine, and distilled spirits.

During their budget negotiations, however, lawmakers left out of their calculations two expenditures that will

cost taxpayers billions of dollars in years to come: Operation Desert Shield, and the escalating costs of the savings and loan bailout. Add to these the estimated \$50 billion in lost revenue due to the current recession, and the estimated fiscal 1991 budget deficit rises to well over \$400 billion.

State-Level Finance

Following federal trends, total state tax revenues increased as numerous states raised tax rates. In 1990, state revenues jumped nearly \$20 billion, a 7.5 percent increase from the previous year's take. More than 31 states raised taxes, mostly sales taxes covering gasoline and cigarettes.

Well before the economic downturn was felt at the national level, several states found themselves in dire financial straits. In particular, California, Massachusetts, New Jersey, New York, and Virginia faced huge budget deficits. Most states cannot rely on deficit spending in a budget crunch because their constitutions require a balanced budget, leaving them only the politically difficult options of cutting spending or raising taxes.

California

Facing a \$2.7 billion fiscal 1990 budget deficit, California lawmakers considered tax increases of more than \$1.1 billion on sales, alcohol, and personal and corporate income. Governor Deukmejian opposed any tax increases and wanted the fiscal shortfall to be met by cutting the state budget. Faced with 17 initiatives on the November ballot, California voters turned down the five major tax initiatives. They included legislation to make it more difficult for state and local governments to raise taxes, an increase in the general sales tax from 4.75 percent to 5.25 percent, and an increase on the excises of alcoholic beverages. The only major initiative voters approved was Proposition 140, which imposes a two-term limit on state senators and a three-term limit on state assembly members.

Massachusetts

Massachusetts began the year facing a projected budget deficit of \$1 billion. Governor Dukakis appointed a

See Tax Policy on page 4

Tax Policy from page 3

task force to address the problem, but lawmakers and business leaders abandoned the plan for economic summits to cut the deficit. The state legislature finally approved a tax increase bill that it had been considering since 1989 in order to balance the state budget.

The bill hit taxpayers with an increase in personal income tax from 5 percent to 5.75 percent in 1990. Massachusetts' taxpayers face a further retroactive increase in 1990 to 5.95 percent and 6.25 percent in 1991. In 1992, the tax will revert to the 1990 level of 5.95 percent. In addition to the personal income tax hike, the tax increase included extending the 5 percent sales tax to professional services (i.e. lawyers, accountants), increasing the capital gains tax from 10 to 12 percent, and increasing the motor fuels tax from 11 to 17 cents.

Massachusetts closed fiscal year 1990 with a sharp decline in tax collections of 3.3 percent, with precipitous drops in sales and corporate income receipts. Personal income collections rose a modest 4.2 percent.

New Jersey

Outgoing Governor Thomas Kean began 1990 by imposing a state spending and hiring freezing due to a possible fiscal shortfall of \$590 million at the request of Governor-elect James Florio. Governor Florio, beginning his term, continued the freeze and proposed a tax hike package of \$1.4 billion to counter the state's fiscal deficit. The

"Governor Florio's tax hike package of \$1.4 billion . . . increased the sales tax and doubled the top personal income tax rate to 7%."

package, passed by both houses, increased the sales tax from 6 to 7 percent, effective July 1, 1990, increased the excise tax on cigarettes and alcohol, effective July 1, 1990, and doubled the top personal income tax rate to 7 percent, effective January 1, 1990.

New York

New York began the year by initiating the final phase of the state's major income tax cut. Governor Mario Cuomo,

however, turned the tables by postponing the tax cut in the budget bill due to the state's difficult financial condition, facing a \$700 million shortfall. Instead of becoming effective in October 1990, the .5 percent reduction of the top rate will be phased in over a three-year period. The top personal income tax rate will remain 7.875 percent for 1990. Also, the new budget delayed an increase of the standard deduction, imposed a three-year corporate income surcharge on tax liability, and raised the cigarette tax rate from 33 to 39 cents. New York City has contributed significantly to the \$700 million deficit with its own projected deficit of \$400 million.

Virginia

Governor Douglas Wilder began his term by ruling out tax increases. Faced with a projected \$1.94 billion shortfall, he announced a plan to cut from the current services budget \$333 million in state aid to local governments and 3 to 5 percent in state agency spending, and to impose a salary freeze on state workers. Wilder has cut his own salary by 2 percent to persuade judges to take a similar step and eliminated a 2 percent salary increase for college faculty. Virginia used a carrot and stick approach with tax evaders, declaring a two-month tax amnesty, which raised more than \$32 million, but at the same time increasing the penalties for tax evasion.

International**Canada**

Canada faced a fiscal deficit of CD\$30.5 billion in 1990. Finance Minister Michael Wilson presented a new Canadian Budget that planned to reduce the budget deficit by freezing spending on government programs for two years and capping other programs for five years instead of raising taxes.

The Canadian government, however, decided to reduce the deficit in part by passing a bill that replaces the current Manufacturers' Sales Tax (MST) with a Goods and Services Tax (GST). The current 13.5 percent MST was levied on a select group of items before the item reached the customer. The new 7 percent GST is a multistage value added tax which covers all goods and services, except basic foods, medical and dental care, drugs, rents, financial services, tuition, and farm goods and services. The GST is estimated to raise

revenues of CD\$5.5 billion to CD\$24 billion. Canadians, who fear that the government will raise the GST rates in the future, were outraged and demanded wage hikes to offset the tax. The tax is effective January 1, 1991.

The Canadian government has granted more than CD\$2.5 billion in research and development incentives to Canadian corporations under the 1985 Scientific Research and Experimental Development Tax Incentive Program. The program entitles corporations performing R&D 20-35 percent tax credits for qualifying expenditures.

United Kingdom

The nation's budget surplus has shrunk from BP2.2 billion to BP400 million as a result of smaller tax and privatization revenues, and higher government spending. This shrinking budget surplus and increased inflation have delayed income tax cuts and increased tension about the new poll tax. The poll tax, effective April 1, 1990 for England and Wales, replaced property taxes and levies a community charge on residents based on the per capita cost of their local governments. It is designed to fund local services, replacing the local traditional property-based rating system. A nationwide debate over the fairness of this measure has included mass demonstrations against the ruling Conservative party and contributed to the lack of confidence in Prime Minister Margaret Thatcher before she stepped down.

The UK's government also imposed a new tax system regarding commercial property taxes that will hit retail companies especially hard, with some suffering a nearly eightfold increase over last year's assessment. The government, however, is providing a five year transition period which limits the increases to 20 percent a year in real terms. An increase in property taxes resulted from a government revaluation of commercial property.

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Investment Abroad**

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Peter Barnes, Deputy International Tax
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Murray Schlusell, Assistant General
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Partner, Price Waterhouse

B. Anthony Billings, Tax Foundation
Senior Research Fellow; Associate
Professor of Accounting, Wayne State
University

John F. Brussel, Tax Director - Interna-
tional, AT&T

**Session #2: Tax Treatment of Foreign
Investment in the U.S.**

Panel Chairman: Robert Ashby, Assistant
Vice President, Taxes, Northern Telecom
Inc.

Congressman Philip M. Crane (R-IL),
House Ways and Means Committee: Trade,
Ranking Minority Member

Elliot L. Richardson, Senior Partner,
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Bruce R. Bartlett, Deputy Asst. Secretary
for Economic Policy, U.S. Department of
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Harrison J. Cohen, Legislation Counsel,
Joint Committee on Taxation

Richard Pratt, Economic Counsellor,
Embassy of Great Britain

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Foreign Investment in U.S. Will Thrive If Reason Conquers Emotion

by Congressman Philip M. Crane (R-IL)

Let's put the debate over foreign investment in its historical context. Americans take a lot of understandable pride in the initiative and hard work put in by their forefathers during the nation's infancy and up through the better part of the 19th century. This period witnessed the most spectacular industrial growth the world had ever seen, and throughout those years, the nation that financed our growth was our mortal enemy — Great Britain.

So despite the current brouhaha over foreigners investing in the U.S., foreign investment has contributed to the great wealth of this nation in the past despite much more adverse circumstances. Indeed, if it were not a good thing, why would so many Americans be foreign investors? As I hear emotional pleas for protectionism, I wonder why the authors of those pleas never condemned Americans investing overseas. It was just last year that foreign investment coming into this country exceeded what we were investing abroad.

In fact, much of the debate on this question is really Japan-bashing. Those who don't have logic and facts to support their positions are resorting to this emotional appeal because many Americans still remember December 7, 1941. British investment here is about \$119 billion; Japan's — \$69 billion. Japan just went ahead of the Netherlands for the first time last year. Where is the condemnation of the British and the Dutch?

I submit that we are living in an increasingly international economy and are bound to countries all over the world. Ironically, many of the same people who argue against foreign investment in the U.S. are in the vanguard of urging investment from this country in the Soviet Union. The whole free market world is making investments over there to help them make the transition to membership in the civilized world. I think that is sound policy.

I have suggested to Japanese executives that they use their extraordinary marketing skills to promote the Japanese people and culture. They have the ability to do it and must recognize that in the ad hominem debate that pro-

tectionists are trying to fashion on this question, Japan is the easiest target.

One Japanese CEO has reminded me that after the war, America insisted upon thousands of their people coming to the U.S. to study our economy so that Japan could become a major industrial power in the shortest possible time. When studying the structure of the tax code at the University of Chicago under Milton Friedman, Friedrich A. Hayek, and George Stigler, all Nobel Prize winners, they learned to write a tax code that rewards saving and investment. As a result, Japan didn't tax interest, dividends or capital gains for all practical purposes. He then asked,

***"Those who don't have facts
to support their positions
are resorting to this emo-
tional appeal because many
Americans still remember
December 7, 1941."***

"Why do you punish your people for saving and investing?" To which the only appropriate answer is, "Because we're jerks, that's why!" We sit back and marvel that as a percentage of personal income, they are saving 20-22 percent annually while the U.S. is at the bottom of the world's industrial nations.

The last thing the U.S. should do is engage in scapegoating, especially singling out one country over another the way we are doing at now, implying that there is some evil conspiracy behind it.

Instead, we should be looking inward to resolve any apprehensions we may feel about foreign investment in this country. There are ways we could reward people for saving and investing in this country. I hope that is the direction the Ways and Means Committee takes when it looks at the question of foreign investment.

Ed. Note: This column was excerpted from Rep. Crane's speech to the Foundation's international investment seminar. The opinions expressed are not those of the Tax Foundation. Editorial replies are encouraged.

Gable from page 1

enforce the "pay-as-you-go" system with timely estimates for all provisions. But Budget Committee Chairman Leon Panetta (D-CA) went more to the heart

"When it comes to pay-as-you-go, 'OMB is more concerned about the paying than the going,' as Rep. Silvio Conte (R-MA) said during the floor debate."

of the matter when he said, "Members did not want to negotiate with OMB." The implication is clearly that Members' input on estimates will be more welcome with CBO.

of the only spending restraints in the package. The White House looked forward to being able to artfully position its scorekeeping to keep Congress under control and to advance its own agenda. For example, if the White House had wanted to reignite its capital gains objective, it could have done so because their budget estimates show substantially higher revenues from this source in the years ahead.

I have long been a skeptic of budget summitry in general, and even before the new House rule passed, I felt that OBRA would be no exception: new taxes vigorously and immediately enforced while spending restraints die aborning. And so the demise of this spending restraint on the first day of the new Congress is not surprising, but it is

"[Professional estimators] are more concerned with econometric modeling and microsimulation than with politics. But there is no doubt that the assignment of official estimating responsibility to OMB in the budget negotiation was an important concession to the President's desire to hold down congressional spending."

In fact, OMB's designation as the official scorekeeper was one of the only points the White House gained in last year's budget negotiation, and one

discouraging and cannot help but lessen every realistic observer's hope that OBRA will achieve substantial deficit reduction.

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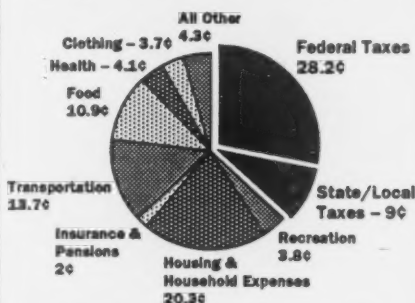
Tax Features

New Budget Has Typical Family Paying \$12,984 in 1991 Federal Taxes

Federal Government To Spend 79 Percent of Taxes on Four Items

In a new Issue Brief entitled *The President's Fiscal Year 1992 Budget and Its Impact on the American Family*, The Tax Foundation summarizes key components of the new budget,

Figure 1
How the Typical American Family Will Spend a Dollar in 1991*



* This example uses a two-earner family earning \$48,000 per year with two dependent children.
Source: Tax Foundation.

then calculates that a typical American family — two workers earning \$46,000 with two dependent children — will pay \$12,984 in 1991 federal taxes. The report examines how the government will spend what it has exacted and what the family will do with the remainder (see Figure 1).

This \$12,984 is a 28.2 percent tax bite from the family's income and will cover its direct and indirect federal taxes, but not state or local taxes.

Direct vs. Indirect Taxes

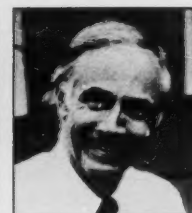
Direct federal taxes — individual income and personal Social Security taxes — will cost the typical family \$8,314 in 1991. However,

See *Family Taxes* on page 7

Economic Agenda for 1991: Two Views



Congressman Lee H. Hamilton (D-IN)



Congressman Willis D. Gradison, Jr. (R-OH)

On pp. 2-3, Congressman Lee H. Hamilton, chairman of the Joint Economic Committee and Congressman Willis D. Gradison, Jr. member of both the House Ways and Means Committee and the Budget Committee, address one of the nation's front burner issues: What measures should the nation take to ensure prosperity in the year to come?

The opinions expressed in the Front Burner are not necessarily those of the Tax Foundation. Editorial replies are encouraged.

New Special Report Shows Distribution of 1991's Federal Tax Burden by State

A new study by Tax Foundation economist Paul G. Merski shows the federal tax burden in FY1991 increasing 6.1 percent nationwide over FY1990's level. Federal taxes will hit \$1,060.7 billion in 1991, as compared to 1990's \$999.5 billion, according to analysis of the new FY1992 budget. Individual taxpayers will pay \$26 billion of this increase in higher income tax payments, up 5.5 percent over last year.

Entitled *Federal Tax Burden by State*, the study breaks down Uncle Sam's increasingly heavy tax burden by state.

The State-by-State Picture

The national per capita federal tax burden will rise \$209 to \$4,235 in FY1991, and each state's per capita federal tax burden is shown in the map on page 4. Ranked from highest to lowest, the residents of the following nine

See *Federal Tax Burden* on page 4



Tax Foundation

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A Three-Point Plan to Fight the Recession

By Congressman Lee H. Hamilton

Some in Washington have avoided the word, but it is no surprise that this economy has been defined as in recession. That leaves three key tasks: first, to cushion the human costs of the recession; second, to get out of the recession as quickly as possible; and third, to build a strong and solid recovery.

Cushion the human costs. The unemployment rate is up to 6.1 percent. Every tenth of a percentage point represents more than one hundred thousand workers.

We've lost more than 650,000 manufacturing jobs since last year, and even service employment is soft. Recessions since World War II have increased the unemployment rate by at least 2 percentage points; if that pattern holds, it would put us close to 8 percent.

To cushion the human costs, we need to help those who lose their jobs; but the proportion of the unemployed who actually receive unemployment benefits has dropped from

"We should not counteract the downturn with 'pump-priming;' we already have enormous stimulus through our large deficit."

50 percent ten years ago to 33 percent today. States have tightened eligibility requirements, and the federal Extended Benefits program for those out of work for longer than six months has been virtually eliminated. During this recession, many jobless workers could exhaust their benefits. The Extended Benefits program should be reinvigorated. The additional costs would automatically decline as the economy improves, so the long-term budget impact would be small.

Shorten the recession. The best way to shorten the downturn is a more stimulative monetary policy. Lower interest rates will encourage construction (currently the weakest sector of the economy). Further, lower interest rates are the best remedy for the shakiness of many financial institutions. We should not counteract the downturn with "pump-priming;" we already have enormous stimulus through our large deficit.

Build for a sound recovery. Our long-term goal—a strong and solid recovery and expansion—is also served by lower interest rates. A lower cost of funds encourages investment, which increases our productivity and capacity to produce.

The Federal Reserve has eased credit. Still, the Fed does not control the long-term rates that influence investment; rather, it pushes short-term rates, expecting long-term rates to follow. But if the Fed lowers short rates, and investors—especially foreign investors—see that as inflationary accom-

modation of irresponsible budget policy, the market can run the other way and raise long-term rates. And in the last week, the Fed has been forced to cut short-term rates sharply to offset the softness in the economy.

That is why the Congress and the President must show that we are serious about getting our deficit under control and enforcing the budget law. One thing we know will increase future growth is increased national saving, so that we can invest without dependence on foreign creditors. And the one sure way to increase our national saving is to reduce the federal deficit. Credible budget policy not only permits countercyclical short-term monetary policy, it is also a long-term growth policy.

Our yardstick for judging our budget policy should be our rate of national saving. The Joint Economic Committee calculates that the deficit reduction agreement will take us only about halfway to the rate of national saving available for private investment that we had in the 1960s and the 1970s—if it is implemented reasonably well, and if the economy recovers moderately. Fully restoring that level of saving will require about an additional \$80 billion of budget savings in FY95.

By these standards, there is no question that we will need to revisit the budget deficit; the deficit agreement was a big step, but it did not finish the job. We have done about as

"There is no question that we will need to revisit the budget deficit; the deficit agreement was a big step, but it did not finish the job."

much as we can do in a weak economy, however. Squeezing further deficit reduction now would further weaken the economy, and further increase the deficit. What we need instead is a credible commitment to bring the deficit down after the economy recovers. At the very least, we must uphold budget process discipline.

Finally, to achieve long-term growth, we must increase public investment in human capital, infrastructure, and technology—as well as private investment in factories and machines. Our prosperity and competitiveness are threatened by workers who cannot perform basic math; by roadways and airways that cause delays (and in the case of our roads, damage the vehicles on them); and by forgone opportunities for research and development. We have fallen behind in these investments; we need to increase our efforts, and finance those efforts responsibly.



Rep. Lee H. Hamilton

Congressman Lee Hamilton, Democrat from Indiana's 9th district since 1965, serves as the chairman of the Joint Economic Committee.

Stable Fiscal Policy Is Key to Recovery from Recession

By Congressman Willis D. Gradison, Jr.

The broad economic consensus forecast for 1991, including those by Chairman Greenspan and the Congressional Budget Office, is a mild recession ending sometime this summer. Preliminary signs indicate that the worst may already be over. Of course, a lot depends on events in the Persian Gulf region and interest rates.

To decide what, if any, actions might be appropriate in response to this economic downturn, it is necessary to understand its likely causes. The first candidate is the oil price shock which occurred in August. However, the slowdown started in June and the magnitude of the shock was not great enough or long enough to cause the recession. So, while oil price increases may have aggravated the slump, they did not cause it.

On the demand side, a noticeable decline in consumer confidence has led consumers and businesses to reduce their spending. However, this started in the second quarter of 1989, and while it may represent a partial explanation, it is not the proximate cause. To be sure, events in the Gulf exacerbated the fall in consumer and business confidence and have made many reluctant to buy big ticket items.

For the past several years, fiscal policy has been slightly expansionary, as measured by an increasing structural deficit—what the deficit would be if the economy were operating at full-employment. Fiscal policy has not caused this slowdown. The administration's proposed budget continues this trend. In 1992, fiscal policy would add an additional \$13 billion of stimulus to the economy.

The most likely candidate is monetary policy, which has been contracting for some time now. Potential GNP growth—the sum of labor force growth, productivity growth, and changes in unemployment—was about 2 percent last year, but the economy was growing faster than that, so inflation increased. This caused the Federal Reserve to restrict money

"To decide what . . . might be appropriate in response to this economic downturn, it is necessary to understand its likely causes. . . . The most likely candidate is monetary policy, which has been contracting for some time now."

supply growth. Unfortunately, the Fed probably thought the economy was growing faster than it actually was, so that instead of contracting from a GNP growth rate of 3.5 percent, the Fed pushed it down from 2.5 percent. As a result, the

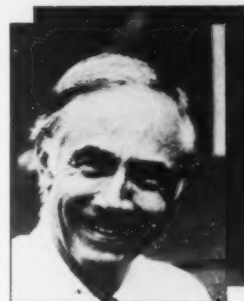
Representative Gradison is the Ranking Republican on the House Budget Committee and serves on the House Ways & Means Committee. He has represented Ohio's 2nd district since 1975.

economy slowed more than the Fed, or anyone, desired.

This analysis indicates that government's proper response is to build upon the fiscal policies embodied in last year's budget reconciliation act (OBRA'90)—significant deficit reduction,

and let the Fed continue to lower interest rates. So far, the Fed has lowered the discount rate a full percentage point since last year, and currently, the Fed and the Treasury are looking for other ways to encourage banks to lend more.

Hopefully, a relatively stable fiscal policy and a looser monetary policy will lead to a speedy recovery and return the country to a stable rate of economic growth with full employment. In the long-run, though, the United States faces significant economic challenges. The most critical is raising



Representative Willis D. Gradison, Jr.

"Ideally, the federal government should run a surplus of about 3 percent of GNP to offset the negative effects on national savings of governmental programs."

national savings. Our historically low rate of national savings adversely affects our trading accounts, our rate of economic growth, and makes us dependent upon foreign sources of capital. The surest way of reversing this situation is to reduce the federal budget deficit. OBRA'90 was a start, but more should be done. Ideally, the federal government should run a surplus of about 3 percent of GNP to offset the negative effects on national savings of governmental programs.¹

In the 1990s, exports may prove to be the key to future U.S. economic growth, partially as a result of the inevitable turn around in our trade accounts. Indeed, over the past few years, exports have emerged as an engine of economic growth. In 1986, net exports reduced GNP growth by 25 percent, but since then they have been a powerful source of growth. Over the past three years, they have represented about 10 to 25 percent of total GNP growth.

We in Congress can help encourage this trend. Impediments in the tax code, which discourage foreign sales, and foreign trade barriers can be reduced, and U.S. export controls can be further streamlined.

If this recession is short and shallow, fiscal policy should begin to contract, allowing a somewhat looser monetary stance. The resulting higher rate of national savings, because of lower federal deficits, should reduce our dependence on foreign investment and raise American living standards.

¹ Bill Gradison, "Is a Balanced Budget Enough?" The AEI Economist. July 1987.

Federal Tax Burden from page 1

states and the District of Columbia will pay the most:

1) CT \$6,801	6) NY 5,285
2) NJ 6,314	7) MD 5,116
3) DC 5,764	8) DE 5,085
4) MA 5,487	9) NH 4,921
5) AK 5,442	10) IL 4,816

The average Federal tax burden for citizens in the top ten states is \$5,503. On the other hand, the lowest burdens, averaging \$2,900, are borne by taxpayers in the following states:

51) MS \$2,456	46) LA 2,970
50) WV 2,782	45) SC 2,994
49) UT 2,800	44) ID 3,010
48) NM 2,915	43) AL 3,066
47) AR 2,924	42) SD 3,078

Citizens in the top ten states pay an average per capita tax burden that is \$2,603 higher than citizens in the lowest per capita states. The recent trend in the per capita federal tax burdens is shown in the figure at right.

Tax Burden Outlook

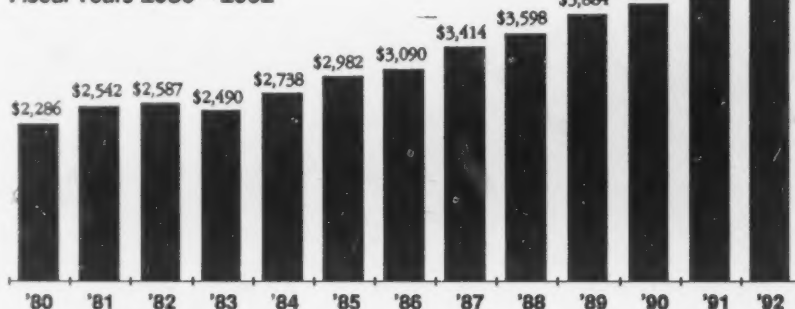
It should be noted that the federal tax burden calculation does not count

federal budget deficits. For example, the estimated \$318 billion federal budget deficit for 1991 is not included in the calculation of the tax burden for that year. However, continued deficit spending does fuel a growing national debt, now over \$3.3 trillion. The cost of servicing this debt will cause future increases in the tax burden and a weaker

economy. The cost to the nation of the current recession, Operation Desert Storm and the S&L bailout is unknown because the tab on each one is still running. But even the conservative estimates run into the tens of billions for each and certainly do not augur well for the possibility of a decline in the federal tax burden.

Per Capita Total Federal Tax Burden

Fiscal Years 1980 - 1992



Source: Tax Foundation

Per Capita Total Federal Tax Burden by State

Fiscal Year 1991



Source: Tax Foundation

The Capricious Alternative Minimum Tax

A widely accepted principle of tax equity is that parties in equal positions should be treated equally. Unfortunately, the corporate alternative minimum tax (AMT) treats corporations with generally the same long-term economic incomes quite differently. The differences capriciously relate mainly to the timing of preference generating activities.

The AMT was designed to ensure that all corporations reporting income paid at least some tax. Its proponents claimed reasonableness by referring to preferences as economic income not subject to regular tax; however, actual preferences did not turn out to be so limited. The AMT was

"Corporations with variable income do pay AMT, and they pay it when they can least afford it."

soon seen as a significant revenue source, and present proposals to modify the AMT are mainly revenue driven.

A taxpayer is in an AMT posture (have an excess of tentative AMT over regular tax) whenever regular domestic source taxable income is less than 20/14 times his preferences. The AMT hits most corporations only on occasions when regular taxable income is low and while preferences remain high. Corporations with stable, high profit margins are seldom affected. Corporations with variable income do pay AMT, and they pay it when they can least afford it. This extra burden on less profitable firms is clearly anti-competitive.

AMT preferences relating to depreciation are not only large but vary widely with phase-in effects and with each company's historical capital spending pattern. They include both the primary depreciation preference and the accelerated depreciation contribution to the ACE (adjusted current earnings) preference. The primary depreciation preference equals the excess of regular tax depreciation (200 percent declining balance over property group lives) over slower AMTI depreciation (150 percent declining balance over class lives). The rather redundant ACE preference is three quarters of the excess of ACE income over AMT income. ACE income is defined by straight line depreciation over class life. This clearly cannot be economic depreciation because it incorporates no allowance for inflation. The combination of the several deprecia-

tion preferences leaves a net depreciation deduction which is just slightly faster than straight line.

Preferences related to depreciation did not reach substantial size until three years after AMT enactment. They should be especially burdensome for the years 1990 through 1994 when phase-in effects more than double their size. Figure 1 illustrates the size of depreciation preferences during and after phase-in for a representative company with constant, 8 percent/yr growth (including inflation) in capital spending. Did Congress really intend to especially burden firms which by chance have lower profit margins in particular years?

Depreciation preferences are a direct function of capital spending, but that function is often misunderstood. The first several years after each asset is placed in service, regular tax depreciation is greater than straight line and preferences rise; later on, the opposite is true. The preference amount is thus a direct function of the amount of almost new depreciable assets. This means that the higher the rate of company growth, the larger the depreciation related preferences. They can be high for capital intensive companies, but after phase-in, that should only be true if accompanied by solid growth. Can it be good tax policy to penalize rapidly growing firms?

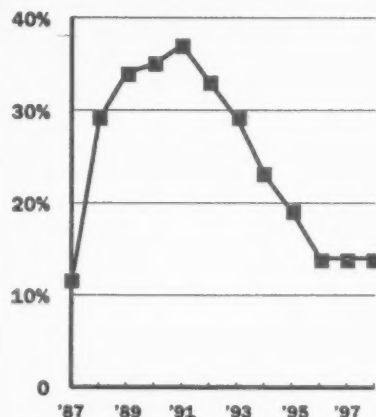
Depreciation based preferences are especially burdensome to companies whose growth is cyclic. It is normal for such companies to markedly increase capital spending in response to higher capacity utilization and higher prices. After new capacity has been brought on stream, prices and margins fall while depreciation preferences climb to new peaks. Companies which rapidly increased capital spending during the 1987-1990 period will see a bad combination of phase-in and cyclic effects.

Summing up, the key determinant of a corporation's AMT liability is its ratio of current year profit to recent year capital spending. The AMT becomes a burden mainly when profits and preferences are out of a phase. This tends to be in times of recession. Although a very low rate AMT may be politically expedient, it is bad tax policy to use this capricious tax to collect major amounts of revenue.



Gilbert A. Harter
Associate Director -
Tax
Dow Chemical

**Total AMT Depreciation
Preference As a Percentage of
Yearly Capital Placed in Service
Calendar Years 1987 - 1998**



Impact on representative company
growing steadily at 8 percent per year.

With the current slowdown in the U.S. economy, what do you see as a top federal tax policy priority in 1991 to best ensure corporate strength and economic growth?

The decade of the eighties saw significant changes in the U.S. federal and state income tax structure coupled with real economic growth in the business sector. Entering the decade of the nineties there is a need to maintain and broaden that economic growth. The current slowdown heightens the importance of setting policies that will strengthen our economy and provide capital for sustained growth. A key factor in meeting this challenge is to maintain, or reduce even further, the current corporate tax rates.

In his recent state of the union address, President Bush confirmed what almost every business executive already knew about the U.S. economy — our country has entered a recession. Economic indicators point to the possibility that this recession may be slight and could "bottom out" by summer. Our policymakers must be careful, however, to avoid taking a recovery for granted. Raising the corporate tax rates at this juncture would almost certainly diminish future growth and may even sink our economy deeper into recession. Even the hint of future rate increases would have a debilitating impact on a projected recovery.

Congress made a commitment to economic growth with the passage of the Tax Reform Act of 1986. This legislation served to broaden the overall tax base in ex-

"Even the hint of future rate increases would have a debilitating impact on a projected recovery."

change for a reduction in tax rates. Preferential treatment afforded some businesses was minimized, creating a more level playing field for all taxpayers. The retail sector, for one, gave up the benefits of the deferral of income under the installment sale rules. The business community accepted these changes in the belief they would serve to maintain economic growth for the entire country, adding to the business expansion which began in the early eighties.

Congress must maintain the commitment it made in passing the tax laws which reduced the corporate tax rate. The foundation for reaching corporate strength and economic growth will be to provide the investor and business community with a consistent, predictable environment for decisionmaking wherever possible.



James P. Bryant
Vice President & Director,
Corporate Taxes
J. C. Penney Company, Inc

To quote Federal Reserve Chairman Alan Greenspan, "Assessing the economic outlook is especially daunting at the present time." All that can be said with any certainty at this writing is that the U.S. debt can only worsen as a consequence of ongoing bank bailouts and the Persian Gulf War. To write of necessary tax incentive changes, while possible additional necessary federal taxes are being discussed in Washington, would be a waste of both this writer's and his reader's time.

Does that mean that corporate America should focus its 1991 tax legislative agenda solely on a defensive strategy to prevent new taxes and increases in existing taxes? The answer is NO. Positive steps can be taken by Congress to bolster corporate strength and economic growth without causing significant cost to the Treasury by adopting tax simplification measures. Many burdensome, time-consuming requirements on U.S. taxpayers generate little, if any, federal revenues. In fact, if the cost of IRS policing efforts are included, some provisions may actually be resulting in a loss of federal revenue.

In May 1990, the Committee on Ways and Means of the U.S. House of Representatives published a report containing written proposals on tax simplification. If enacted into law, many of those proposals, together with additional taxpayer simplification recommendations, could greatly simplify the international and corporate provisions of U.S. tax law. Among the items that should be addressed are: coordination of the anti-deferral provisions; revision or elimination of separate limitations for dividends from non-controlled Section 902 corporations; repeal of the high tax kick-out rule; and revision of the computation of AMT foreign tax credit limitation. In addition to this list, which is not meant to be complete, the overly complex and ever-changing pension and employee benefit area warrants simplification.

These low-cost improvements to the law could realistically be enacted in 1991 and serve as a catalyst toward further, more wide-reaching and substantive improvements, ultimately resulting in increased American corporate strength and economic growth.



Michael Ambler
General Tax Counsel
Texaco Inc.

Viewpoint is designed to bring concise opinions from experts in tax and fiscal policy to the readers of Tax Features. Every two months a question that is currently being debated by policymakers and the media will be addressed in this column. Editorial replies are encouraged.

Family Taxes from page 1

direct levies are by no means the whole tax burden, accounting for only about three-fifths of what the government takes in. To these must be added such indirect taxes as the employer's share of Social Security taxes; corporate income taxes; excise taxes on such items as gasoline, liquor, and tobacco; and miscellaneous levies.

Family Spending After Taxes

The family's first obligation after federal taxes is to state and local government. As Table 1 indicates, this additional tax payment brings the portion that taxes take from the typical family's income to a hefty 37.3 percent. With the remaining disposable income, the family spends the bulk of its income on three items: housing and household expenses — 20.3 percent; transportation — 13.7 percent; and food and tobacco — 10.9 percent. After taxes and these expendi-

Table 1
Average Family's 1991
Budget After Taxes

Spending Category	Dollar Amount	Percent of Income
Family Income	\$46,000	100.0%
Total Taxes	17,139	37.3
Federal Taxes	12,984	28.2
State and Local Taxes	4,155	9.0
After Tax Income	28,861	62.7
Total Personal Consumption Expenditures	28,861	62.7
Housing and Household Operations	9,329	20.3
Transportation	6,291	13.7
Food and Tobacco	5,031	10.9
Health/Personal care	1,872	4.1
Recreation	1,747	3.8
Clothing	1,716	3.7
Personal Insurance and Pensions	911	2.0
All Other	1,986	4.3

^a This example uses a two-earner family earning \$46,000 per year with two dependent children.
Source: Tax Foundation.

tures, less than 18 percent of the family's income is left for such items as health care, recreation, clothing, personal insurance and pensions.

How Does the Federal Government Spend the Tax Take?

Of that \$12,984 the typical family surrenders to Uncle Sam, nearly 80 percent will be commandeered by just four federal spending categories:

■ Income Security. It tops the list with \$473.5 billion in federal govern-

FOUNDATION MESSAGE

European Tax Conference Explores Sticking Points Between Treaty Partners

Dan Witt
Vice President

International investment plays an important role in the U.S. economy, not just for the earnings statements of U.S. firms doing business overseas and foreign-based firms located here, but because it creates markets for U.S.-manufactured products and provides capital for domestic economic growth. U.S. national policy regarding foreign investment is still marked by legislation that was passed in a bygone economic era. More thought needs to be given to modernizing our tax policy, assuring that it promotes economic growth.

One area that especially needs policymakers' attention is assuring a free flow of goods, services and capital across borders. Unimpeded inbound, as well as outbound, investment is critical to growth in a global economy. With a mind to elucidating these issues, the Foundation established a multi-year international tax assessment project consisting of seminars, special studies, and briefings with tax specialists designed to inform tax policy makers and business leaders on international taxation. Specifically, the focus is on the consequences of tax provisions affecting the foreign affiliates of U.S.-based companies and the U.S. affiliates of foreign-based companies.

One of the building blocks of our international tax project was a seminar we sponsored in late September 1990 where corporate leaders of U.S.- and foreign-based multinationals and top government officials made presentations on such pertinent subjects in tax policy as treaty overrides, transfer pricing and the complexity of reporting requirements. Out of this seminar grew an idea for an overseas conference bringing together foreign and U.S. government tax specialists to more fully explore these issues.

The capitals of the U.S.'s principal European trading partners, London, Paris, and Bonn, as well as Brussels, capital of the European Community, were chosen for the trip which took place from January 9 through the 17th. Among the foreign fiscal authorities involved were UK Inland Revenue officials Richard Pratt, Head of European Community and International Trade Issues; Peter Fawcett, International Division - Policies; and Ian N. Hunter, International Division - Technical; Willy de Clercq, Chairman of the External Relations Committee in the European Parliament; Emmanuel Constans, Chief of Staff, Commission of European Communities in the Office of Christiane Scrivener, Commissioner for Taxation in the European Community; and Michael Taly, Director, Fiscal Affairs, French Ministry of Finance.

By facilitating this type of communication, the Foundation fulfills its role as an educator, not just of the public, but of policymakers. Constructive dialogue among trading partners can only lead to a U.S. tax policy better able to meet the challenges posed by the world economy.

ment spending and includes Social Security, federal retirement, and unemployment compensation. It will claim 32 cents from each dollar the American family sends to Washington, for a per-family total of \$4,148.

■ National Defense. Second in size,

this will cost \$295.2 billion — or 20 cents out of each tax dollar. The family's annual defense tab: \$2,587 per year.

■ Interest on the National Debt. Ranking third at \$206.3 billion, this

See Family Taxes on page 8

Family Taxes from page 7

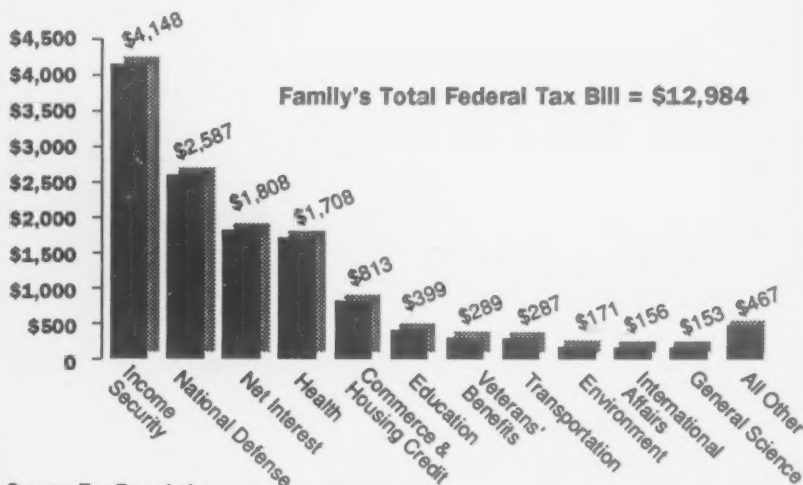
payment accounts for 14 cents of the family's tax dollar, or a whopping \$1,808 per year.

■ **Health Outlays.** Comprised mainly of Medicare and Medicaid, health expenditures will preempt 13 cents of each tax dollar. The typical family will send Uncle Sam \$1,708 in 1990 to pay for the \$195 billion national health bill.

These four items alone will cost the typical family \$10,251, or 79 cents of each tax dollar. Spending on all other programs pales in comparison. With the remaining 21 cents, Uncle Sam will spend 3 cents of the family's tax dollar on education, and less than 3 cents each on environment, transportation, science, and administration of justice. (See Figure 2 on page 7 for more detail.)

Figure 2

How the Federal Government Will Spend the Typical Family's Tax Payment in 1991*



Source: Tax Foundation.

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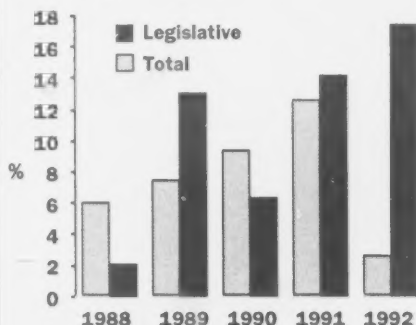
Tax Features

Legislative Branch Spending Will Top \$2.5 Billion in FY'91

Pay Raise Helps Hike Congress's Price Tag to \$1.2 Billion

On January 1, 1991, Members of the U.S. House of Representatives received a 25 percent increase in salary, pursuant to the Ethics

Total Outlays vs. Legislative Outlays
Percentage Change FY1988 - 1992*



* Based on FY1992 Budget released February 1991. FY 1991 and 1992 are estimates.

Reform Act of 1989, compounded with a 3.6 percent cost of living adjustment (COLA). The result was a salary boost from \$96,600 to \$125,100 per year. Senators received a 3.6 percent COLA, increasing their salaries from \$98,400 to \$101,900. These raises have contributed to the record-sewing price that taxpayers will pay to fund the operations of the nation's legislative body during fiscal year 1991.

Overall spending on the legislative branch is estimated to rise \$317.5 million in FY1991, hitting an all-time high of over \$2.5 billion. While total federal spending is estimated to increase 12.6 percent this year, legislative branch spending will increase at an even faster rate of 14.2 percent.

The cost of Congress itself, now over \$1.2 billion, has more than doubled since 1980 and

See Cost of Congress on page 5

Outlaw Retroactive Taxation



Senator David Boren

In our society, we ask the business community to shoulder many burdens. We ask that business comply with health regulations, en-

vironmental requirements, labor standards, and countless other measures to benefit society. However, sometimes we ask too much. Out-guessing the IRS is one of those tasks that taxpayers, whether individuals or businesses, can not be expected to do.

Sadly, it has become almost common practice for the IRS to offer what are known as "temporary" regulations, which require taxpayer compliance not from that day forward, but from the date the statute was first enacted. This retroactive taxation puts an unfair burden on business, reduces productivity, eliminates jobs and causes unnecessary confusion throughout the private sector.

For years, the IRS has enjoyed carte blanche authority in its regulation of taxpayer affairs. While the passage of the "taxpayers bill of rights" made some progress in putting taxpayers on an even footing with the IRS, more work remains to be done. The need to eliminate retroactive taxation is part of the taxpayers' unfinished agenda.

Retroactive regulation is unfair to taxpayers because it changes the rules in the middle of the game. Taxpayers who followed the rules are held hostage by the IRS, whose bureaucracy can make retroactive changes and hold the taxpayers responsible for not following standards they could never have been expected to know.

See Boren on page 2

Senator David Boren, Democrat from Oklahoma, serves on the Senate Finance Committee and chairs the Subcommittee on Taxation.

The opinions expressed in the Front Burner are not necessarily those of the Tax Foundation. Editorial replies are encouraged.



Tax Foundation

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Boren from page 1

This year, I have joined with a few of my colleagues in the Senate Finance Committee to prevent the Treasury Department and the Internal Revenue Service from writing retroactive tax

"Sadly, it has become almost common practice for the IRS to offer what are known as 'temporary' regulations, which require taxpayer compliance not from that day forward, but from the date the statute was first enacted."

regulations. The "Taxpayer Regulatory Relief Act of 1991" (S. 532) would prohibit the IRS from enforcing a regulation during the window between the date the statute was first enacted and the time the agency issued temporary regulations.

I have been joined by Senator David Pryor (D-AR) and Senator Max Baucus

"The 'Taxpayer Regulatory Relief Act of 1991' (S. 532) would prohibit the IRS from enforcing a regulation during the window between the date the statute was first enacted and the time the agency issued temporary regulations."

(D-MT) in introducing this legislation which is very similar to S. 3161, introduced by Senator Pryor and myself in the 101st Congress.

The legislation requires that as long as taxpayers comply with new tax law in "reasonable good faith," they will be liable only in years after the regulations are issued. Congress will still have the option to grant an exception to this prohibition if we desire to authorize the Treasury Department to issue retroactive regulations with respect to a specific statutory change. The bill would apply

with respect to any temporary or proposed regulation published as a final regulation after March 1, 1991.

So far, the measure has received enthusiastic support from the business community and from the grassroots. The U.S. Chamber of Commerce, the National Federation of Independent Businesses, the Small Business Legislative Council, and the National Small Business United all endorsed the measure.

It is clear that the business community realizes that the current IRS method is bad for the economy and has a chilling effect on legitimate business transactions. More money is probably

"More money is probably lost to the treasury due to these fears [of prosecution] than is gained by the taxes."

lost to the treasury due to these fears than is gained by the taxes. Many small companies simply will not engage in certain transactions out of fear of retroactive taxation, and given the potential costs of IRS prosecution, this is a reasonable fear.

The average taxpayer is getting tired of unrealistic and arbitrary demands sent down by bureaucrats. I have received dozens of phone calls and letters from across the nation urging the bill's passage, and I have urged

"Many small companies simply will not engage in certain transactions out of fear of retroactive taxation, and given the potential costs of IRS prosecution, this is a reasonable fear."

all my colleagues to consider the detrimental economic effects of retroactive taxation and to join me as co-sponsors.

As chairman of the Subcommittee on Taxation in the Finance Committee, I plan to push for hearings on this proposal to press for the bipartisan support needed to enact the measure into law.

Foundation Seminar To Analyze Code's Impact on Corporate Strength and Economic Growth

On May 22, 1991, the Tax Foundation will conduct a seminar in Washington, DC, entitled "Rebuilding the U.S. Industrial Base: The Role of Tax Policy in Economic Growth."

The seminar will feature for its keynote address Lawrence Lindsey, Special Assistant to the President for Policy Development and Associate Director for Domestic Economic Policy. Other panelists will be noted experts from business, government and academia.

Topics to be covered include the economic impact of increasing levels of corporate taxation, tax obstacles to service sector expansion, tax impediments to transborder investment, the level of taxation on foreign source income, and pro-growth tax policies, i.e., R&E tax policies, capital gains tax differential, and capital cost recovery issues.

The seminar will examine our current tax policies and develop a sound pro-growth tax agenda that will help insure economic strength in the long term. For additional information about attending, call Gretchen Geordiadis at 202-863-5454.

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"Federal Tax Burden by State"

by Paul G. Merski and Gregory Leong

8 pp. \$10 + \$2 p/h; members: \$5

Implications of U.S. Tax Policy for Treaty Partners

By Lindy L. Paull

From January 9th through the 17th, I attended Tax Foundation-sponsored meetings in London, Paris, Brussels, and Bonn to explore the "Implications of U.S. Tax Policy for Treaty Partners." These comments are my observations on the European perspective; they are not intended to represent the views of the other participants or of the Tax Foundation.

At the Tax Foundation's international tax conference, it did not take long to discover the "hot buttons" of our European treaty partners:

- Unilateral overrides of tax treaties by the U.S.;
- Proposals to tax capital gains of foreign investors;
- Proposals to change the arm's length price standard for transactions between related companies;
- New reporting requirements for foreign-owned firms;
- New earnings stripping rules; and
- Unitary taxation by states.

Generally speaking, foreign officials and investors see our recent tax legislation as barriers to foreign investment in the U.S. Investors claim to have incurred substantial costs complying with the frequent changes to U.S. tax law, a complaint echoed by many domestic businesses, and question our desire for further investment by foreign-based firms.

Treaty Relations

European participants observed that the U.S. has initiated many tax treaties which provide order in the international business arena, protect against double taxation, and ensure each jurisdiction a fair share of tax. Now, they say, the U.S. is eroding other nations' confidence in tax treaties, and they point to a statement by Senator Sarbanes in June 1990 to the effect that, since the U.S. has overridden tax treaties in the past, our partners could expect overrides in the future.

Our partners want the U.S. to renegotiate, not override. Only rare circumstances such as a court's reinterpretation of law or abuse of the treaty justify override legislation.

Capital Gains of Foreign Investors

In 1989, the House-passed budget reconciliation bill would have taxed capital gains of foreign investors on the sale of a 10-percent-or-more interest in a U.S. company. The provision, dropped in conference, would have expressly overridden U.S. tax treaties. A similar proposal, without the treaty override feature, was introduced in 1990 by Congressmen Gephardt and Rostenkowski. Both proposals were cited by Europeans as examples of tax legislation that would create barriers to foreign investment in the U.S.

Transfer Pricing

European participants were unanimous in supporting arm's length pricing as the standard for related company

transactions. They admit it can be troublesome but feel its problems have never been insurmountable. U.S. proposals to change it, such as the 1988 Internal Revenue Service white paper suggesting comparable uncontrolled prices, raise the spectre of possible double taxation to our treaty partners.



Lindy L. Paull

Reporting

In 1989, the U.S. Treasury was given authority to require information about the business activities of foreign-owned companies. Tougher penalties were added in 1990. European multinationals think the reporting rules have gone too far, and they worry about the cost of compliance and about safeguarding business secrets. Frequently charged with skirting U.S. tax law, they provided us with data compiled from I.R.S. Statistics of Income for 1984 through 1987, showing foreign-owned companies accounted for roughly six percent of all U.S. corporate assets and receipts, and paid about six percent of the U.S. corporate income tax collected.

European government officials, on the contrary, agreed with the policy underlying the U.S. reporting requirements and acknowledged that their countries had similar rules.

Earnings Stripping

I was left with the impression that the much ballyhooed earnings stripping rules have not in practice affected anyone. Companies are able to manage their related party debt to make sure the safe harbor debt-to-equity ratio is satisfied.

Unitary Tax

The recent decision of the California Court of Appeals holding the California unitary method of income taxation as applied to foreign multinational companies unconstitutional was obviously given high marks by the foreign investors attending the conference. (Barclays Bank International Ltd. v. Franchise Tax Board, November 30, 1990.)

European Community (EC 1992)

Because tax decisions require unanimous instead of majority vote, they are on a relatively slow track. In 1990, the EC Council approved three tax measures. The Mergers Directive sets up a unified regime for mergers, divisions, transfers of assets and exchanges of stock for companies in different member countries. Tax on gains from cross-border transfers are generally deferred under that directive. The Parent/Subsidiary Directive eliminates withholding tax on cross-border intercompany dividends. Finally, the Arbitration Convention establishes a procedure for tax authorities of the member countries to resolve double taxation disputes. With a few exceptions, these measures are scheduled to be implemented in 1992.

Lindy L. Paull is Minority Deputy Chief of Staff and Chief Tax Counsel for the Senate Finance Committee.

This article is excerpted from a four-page Issue Brief of the same title. Contact the Foundation for copies.

With the current slowdown in the U.S. economy, what do you see as a top federal tax policy priority in 1991 to best ensure corporate strength and economic growth?

Inaction is not usually viewed positively, particularly if it is inaction by the federal government. However, inaction ought to be a top priority when it comes to federal policy in 1991. Specifically, policymakers should refrain from increasing the current corporate income tax rate during a recessionary period.

The corporate tax rate reduction included in the 1986 Tax Reform Act was a trade-off. Numerous tax deductions and other tax benefits were deleted or restricted. Corporations lost the ability to use the investment tax credit and accelerated depreciation, both of which were substantial incentives for economic growth. The only significant benefit most corporations received in the 1986 bill, which was designed to raise corporate income taxes by \$120 billion over five years, was rate reduction.



John J. Ross
General Tax Counsel
Chevron Corporation

"Holding the rates . . . steady in 1991 should be an easy assignment for Congress and a pleasant change from the major tax bills American taxpayers saw virtually every year throughout the 1980s."

Concern over the recession is causing many economists to promote tax reductions. But additional measures to encourage economic growth must be weighed against the increasing federal budget deficit. The gravity of the deficit would seem to overshadow the possible benefits from any tax reduction to stimulate the economy. Even with the enactment of the 1990 Omnibus Budget Reconciliation Act, the fiscal year 1991 and 1992 deficits are expected to be the largest ever—estimated to exceed \$300 billion in each of those two fiscal years. All possible steps, therefore, should be taken to reduce federal expenditures.

Federal Reserve Board Chairman Alan Greenspan urged Congress recently not to raise taxes to pay for the war. "Assessing the economic outlook is especially daunting at the present time," Greenspan argued. He noted that "the risks of making policy mistakes are high." Given the conflicting concerns of paying for the war, stimulating the economy, overcoming recession and avoiding inflation, it would seem only prudent for Congress to stay the course. Holding the rates and the entire tax structure steady in 1991 should be an easy assignment for Congress and a pleasant change from the major tax bills American taxpayers saw virtually every year throughout the 1980s.

In light of the current recession, it is important to consider what impact existing U.S. tax policy has on economic conditions. The reduced corporate rate structure, that has in some measure contributed to sustaining economic growth since 1986, will lose its effectiveness primarily because many corporations will be placed in the position of paying the Alternative Minimum Tax (AMT) in a recessionary period. Unfortunately, the AMT will raise taxes on the sector of the economy that will be creating the jobs necessary to bring the country out of a recession.

By definition the AMT has to create an effective tax rate higher than that which would have been imposed by the normal corporate income tax. Experience has taught us that tax increases imposed during a recession only lengthen and deepen the trough and increase the hardship on everyone.

While there may be an argument for the AMT when corporate earnings should be high as a result of a strong economy, that argument disappears when the economy is failing. For many corporations, the AMT operates as a tax on depreciation. At this point in time, national tax policy should help accelerate capital cost recovery, lower the cost of capital and stimulate investment. The effect of the AMT is to tax growth. Clearly the primary goal of fiscal policy during a recession should be to encourage growth. The perversity of the AMT is that it gives back the tax imposed in hard times



Glenn White
Director of Tax & Assistant
Secretary (retired)
Dow Chemical Company

"The AMT will raise taxes on the sector of the economy that will create the jobs necessary to pull the country out of a recession."

as a credit in good times when the corporation otherwise would pay the normal corporate income tax.

Consequently the operation of the AMT should be suspended until the recession is over. Placing a surcharge on the effects of investment only increases the cost of capital, and dampens the ability to invest. We can no longer ignore the economic costs of investment-stifling tax policies.

Viewpoint is designed to bring concise opinions from experts in tax and fiscal policy to the readers of Tax Features on subjects that are currently being debated by policymakers and the media. The opinions expressed are not necessarily those of the Tax Foundation. Editorial replies are encouraged.

Cost of Congress from page 1

costs over seven times more than it did in 1970. The Senate will run \$456.3 million (\$4.6 million per senator), while the House will require \$698.9 million (\$1.6 million per representative). Joint activities of the House and Senate will cost an additional \$106 million.

Congress maintains a number of legislative agencies, such as the Congressional Budget Office, General Accounting Office, and the Architect of the Capitol, each of which has its own budget. These will cost taxpayers \$1.3 billion in 1991, 14.5 percent more than last year.

What does all this money buy? Taxpayers are primarily paying for four things: Congressional leadership, staff and administration; committees and subcommittees; and legislative agency personnel.

The U.S. Office of Personnel Management reports that the legislative branch now employs over 37,388

"While this year's \$2.5 billion legislative branch spending represents a 14.2 percent increase, 1992 spending is estimated to increase even faster, rising at a 17.5 percent clip for a total cost of \$3 billion."

workers. Congress itself has 19,371 on the payroll — 7,322 in the Senate and 12,049 in the House.

Congress's committee system is comprised of 20 committees and 87 subcommittees in the Senate, employing over 770 professional staff, plus 27 committees and 155 subcommittees in the House, with 1,271 professional staff attached. Adding in the joint committees brings the total to over 50 committees and 250 subcommittees in the congressional bureaucracy, paying a professional staff of over 2,100 people.

While this year's \$2.5 billion legislative branch spending represents a 14.2 percent increase, 1992 spending is estimated to increase even faster, rising at a 17.5 percent clip for a total cost of \$3 billion. Total federal spending for 1992 is projected to increase only 2.6 percent. See details in table at right.

FOUNDATION MESSAGE

Whose New World Order?

The 1991 edition of *State of the World* is out and Lester R. Brown, its lead author, concludes that during the decade of the '90s, tax policy promises to be the most effective instrument in solving the world's environmental problems. The unofficial bible of the environmental movement, *State of the World* is a compilation of articles on deforestation, global warming, waste disposal, etc. As part of their solutions to almost all these problems, the authors call for "green" taxes to punish environmentally destructive activities. In fact, green taxes are one of the linchpins in the environmentalists' version of the "new world order."

At the top of their list of tax targets is the energy industry, specifically the burning of carbon in coal, oil, and natural gas. At \$100 per ton, taxing these fossil fuels is alleged to raise quite a bit of "green," about \$130 billion annually. The authors suggest reducing income taxes commensurate with green tax revenue estimates, but practically speaking, green taxes are more likely to be collected on top of income taxes, not in place of them. Furthermore, green taxes would not be reliable revenue sources. Just as with other corporate taxes, the expected revenue is extremely difficult to estimate, making federal budgeting even more problematic than it already is.

A more serious weakness of green taxes than the difficulty they would cause for revenue estimating and federal budgeting is the issue of who would bear the burden of these well-intentioned taxes. The companies the public identifies with energy production are popular tax targets, but the fact is that *people* pay taxes, even corporate taxes. Customers, shareholders, and employees of those companies will do the paying. That's a big problem with corporate taxes in general — they take money out of the private economy, but it's hard to say who bears the burden. A basic principle of sound fiscal policy is that taxpayers should know who is being taxed. Green taxes do not meet that test.

While we are all hopeful of a better environment, tax policy simply cannot be the vehicle to achieve every societal goal. The purpose of taxes is not to micromanage the economy with subsidies and penalties, and restructuring our federal tax system is not the answer to environmental problems. If the "new world order" includes green taxes, we better stick with the old one.



Dan Witt
Vice President

Outlays for the Legislative Branch of the Federal Government by Unit

Selected Fiscal Years 1970-1991*

(\$Thousands)

Unit	1970	1980	1990	1991
Total	\$343,147	\$1,217,985	\$2,230,497	\$2,547,961
Congress, total	179,159	581,543	1,107,723	1,261,873
Senate	57,585	183,890	381,250	456,295
House of Representatives	108,279	324,569	585,080	698,945
Joint activities	13,295	73,084	141,393	106,633
Legislative agencies, total	163,988	636,442	1,122,774	1,286,088
Architect of the Capitol	18,797	89,496	128,253	252,716
Botanic Garden	620	1,583	2,475	3,795
Congressional Budget Office	-	12,101	18,266	21,438
General Accounting Office	69,857	201,192	362,254	384,585
Government Printing Office	34,141	115,747	120,440	90,003
Library of Congress	49,804	192,740	479,396	495,208
Office of Technology Assessment	-	11,131	18,329	20,789
U.S. Tax Court	2,972	9,703	26,608	31,790
Other	-	13,675	4,119	5,732
Deductions for offsetting receipts	-12,203	-10,926	-37,366	-19,968

* Data for 1991 are estimates from the FY 1992 Budget presented in February 1991.
Source: Office of Management and Budget.

Foundation Members Meet in Washington for Tax Policy Briefing



▲ Michael J. Graetz, Deputy Assistant Secretary of the Treasury for Tax Policy, addresses Tax Foundation Program Committee.

Foundation Co-Chairman James C. Miller III speaks to members assembled at the Old Executive Office Building.



From left at a Capitol Hill Club luncheon: William Dakin, Supervisory Tax Counsel, Mobil Corporation; Robert T. Matsui (D-CA), Member of the Ways and Means Committee; Dan Witt, Vice President of the Tax Foundation; and Byron L. Dorgan (D-ND), Member of the Ways and Means Committee.



▲ Congressman Robert T. Matsui, Democrat from California and member of the Ways and Means Committee, speaks at Capitol Hill luncheon.

Tax Features

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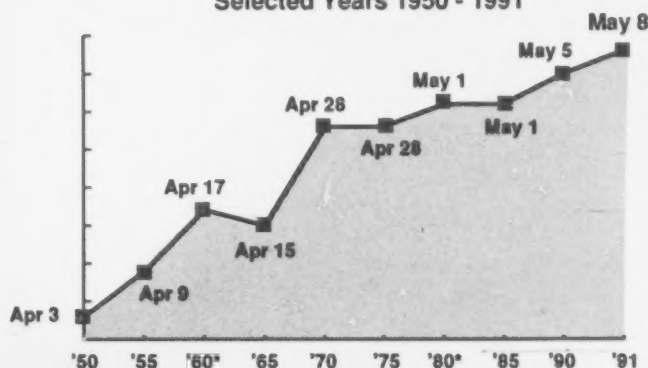
Tax Features

Tax Freedom Day 1991 Is May 8 — Latest Date Ever

State Tax Freedom Days Range from
April 24 to May 26

As Americans scrambled to comply with the
April 15 IRS filing deadline, they may have
thought they would be free from the tax collec-

Tax Freedom Day
Selected Years 1950 - 1991



* Leap year makes Tax Freedom Day appear one day earlier.
Source: Tax Foundation.

FRONT BURNER

Give the Average Taxpayer an Even Break



Senator John Breaux

Once again, tax
time has come
and, as usual, typi-
cal American tax-
payer have grit-
ted their teeth and
written their tax

checks to the IRS for 1990's taxes. Taxpayers
may have a feeling that they have paid their
debt to government, but they would be wrong. Not
until Tax Freedom Day on May 8, when average
taxpayers have earned enough to pay 1991's taxes,
will government be temporarily satisfied.

A Tax Freedom Day of May 8 means that
35.1 percent of each dollar an average taxpayer
earns is taken in taxes. That is a sobering
reminder of our citizens' growing tax burden,
not just from the federal government but at the
state and local levels as well. And as bad as a Tax
Freedom Day of May 8 is, the Tax Foundation's
calculations use total revenues, not total expendi-
tures. Leaving out the deficit makes sense for
calculating tax burdens, but it must be taken
into account when assessing the overall
economy.

While historically massive deficits have
been run up during the 1980s, the real average
weekly wage for non-supervisory workers,
who make up 80 percent of the work force,
declined. During this same time, studies show
that fewer and fewer middle-class Americans
were able to send their children to college or
buy a first home.

This encroachment on the American dream
is in large measure due to the borrow-and-
spend habits of the 1980s. Money which could
be used for pressing needs — educating and
training workers and students, repairing our
infrastructure, cleaning the environment —

See Breaux on page 2

Senator John Breaux, Democrat from Louisiana,
serves on the Senate Finance Committee.

*The opinions expressed in the Front Burner are not
necessarily those of the Tax Foundation. Editorial
replies are encouraged.*



Tax Foundation

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tor at the end of the day, but Tax Freedom Day
doesn't come until May 8 this year. The Tax
Foundation has calculated that to be the day
when the American taxpayer will have earned
enough money to pay this year's total taxes.

That means the average taxpayer will labor
128 days — from January 1 to May 8 — to satisfy
all federal, state and local tax obligations, with
every cent earned from the beginning of the
year going to the tax collectors. Finally, on May
8, he will heave a sigh of relief and start
pocketing some of his hard-earned money.

May 8th is the latest Tax Freedom Day ever.
Last year this task required 125 days and Tax
Freedom Day fell on May 5th. The three-day
lengthening of our labor for government is the
largest jump since 1976, and the Tax Founda-
tion attributes it to several important factors:

- Last year's budget agreement, the Om-

See Tax Freedom Day on page 3

Breaux from page 1

now goes to the ever-increasing interest on the national debt.

There are many ways we can start reversing this trend and begin helping those Americans who need tax relief the most. Here, I propose just four:

1) Let's get serious about reducing government spending.

Every couple of years, Congress and the President emerge from their negotia-

"Money which could be used for pressing needs — educating and training workers and students, repairing our infrastructure, cleaning the environment — now goes to the ever-increasing interest on the national debt."

tions with a landmark deficit reduction plan, but each year the deficit continues to grow. It's no wonder Americans are so cynical about government when their leaders seem to put on a smoke-and-mirrors show for them every year.

The truth is this: There is no easy way out of this budget mess. Washington must simply set aside the gimmicks and

"Every couple of years, Congress and the President emerge from their negotiations with a landmark deficit reduction plan, but each year the deficit continues to grow. It's no wonder Americans are so cynical about government."

the partisan and parochial interests. We must get down to the business of cutting spending, while insuring that everyone pays his or her fair share. The deficit won't come down until our leaders become courageous enough to make some tough and unpopular choices. Further-

more, the American public won't regain its confidence in Washington until they believe they are getting their money's

"Every government program should be forced to defend its usefulness. . . . If a program is a waste of money or is failing to work as intended, why should taxpayers continue to pay for it?"

worth from their government.

2) Every government program should be forced to defend its usefulness.

We must recognize that some of the huge government entitlement programs are not necessarily sacred. Why don't we reauthorize these programs every five to ten years? Let's force the administrators and advocates of these programs to prove they are working and are giving the American taxpayer what he's paying for. If a program is a waste of money or is failing to work as intended, why

"We should increase the personal exemption to what it once was — a real tax break for average Americans."

should taxpayers continue to pay for it?

3) We should give taxpayers back the Individual Retirement Account.

I support a measure to create a "Super" Individual Retirement Account which would allow Americans to use the money, not only for retirement, but for buying a first home, a child's college education or for large medical expenses. This legislation would also restore the annual \$2,000 IRA deduction for every taxpayer. This was one of the most popular middle-class government programs ever, but one of the first to go during the tax reform debate in 1986.

4) We must stop taxing away the funds that average families need to properly raise and educate their children.

We should double the tax deduc-

tion for young children of moderate and middle-class families. In addition, we should increase the personal exemption to what it once was — a real tax break for average Americans.

More than forty years ago, families with two children earning the median income received so many tax breaks through the personal exemption that they paid just two percent of their income in federal, state and Social Security taxes. By 1990, those families paid 23 percent of their income in the same taxes. Today, a horse breeder gets more tax breaks on his horses than parents get on their children. Clearly, it's time to rearrange our priorities.

"Forty years ago, families with two children earning the median income paid just two percent of their income in federal, state and Social Security taxes. By 1990, those families paid 23 percent of their income in the same taxes."

Middle-class Americans are paying more and more taxes and are definitely not getting their money's worth. Who can blame them for being angry when they believe that much of their tax money is wasted on inefficient government programs?

Washington had better start listening to the middle-class. They don't have high-powered lobbyists or political action committees, but they do have the most votes.

Now Available

Two New Tax Foundation Special Reports:

"Tax Freedom Day 1991 Is May 8"

by Paul G. Merski

6 pp. \$10 + \$2 p/h; members: \$5
and

"Fiscal Survey of the States"

by Paul G. Merski and Gregory Leong

8 pp. \$10 + \$2 p/h; members: \$5

Tax Freedom Day from page 1

nibus Budget Reconciliation Act of 1990, will extract \$164 billion in new revenues over five years.

■ The January 1, 1991, increases in the Social Security taxable earnings base.

■ Many state and local taxes have increased sharply.

■ The slowdown in economic growth and individuals' income growth.

The nation's nominal income is estimated to grow only 3.7 percent while the total tax take is projected to increase 6.6 percent. Stated simply, tax increases will easily outpace the growth in individuals' incomes during 1991.

Tax Freedom Day by State

While Tax Freedom Day is May 8 nationwide, each state has its own specific Tax Freedom Day which falls earlier or later in the year depending on local tax and income circumstances (see table 1 and map).

New Yorkers won't celebrate Tax

See Tax Freedom Day on page 4

Table 1
Tax Freedom Day by State

Calendar Years
1990 - 1991

	Tax Freedom Day 1990	Tax Freedom Day 1991	Change from 1990 to 1991		Tax Freedom Day 1990	Tax Freedom Day 1991	Change from 1990 to 1991
U.S. Total	May 5	May 8	3	Missouri	April 25	April 28	3
Alabama	April 21	April 25	4	Montana	May 6	May 4	-2
Alaska	May 11	May 11	0	Nebraska	May 1	May 7	6
Arizona	May 2	May 7	5	Nevada	May 9	May 8	-1
Arkansas	April 22	April 26	4	New Hampshire	April 23	April 29	6
California	May 3	May 7	4	New Jersey	May 9	May 14	5
Colorado	April 28	May 2	4	New Mexico	May 4	May 7	3
Connecticut	May 11	May 17	6	New York	May 23	May 26	3
Delaware	May 18	May 21	3	North Carolina	May 1	May 3	2
Dist. of Columbia	May 21	May 26	5	North Dakota	May 5	May 6	1
Florida	May 2	May 4	2	Ohio	May 1	May 6	5
Georgia	April 27	May 3	6	Oklahoma	April 28	May 2	4
Hawaii	May 16	May 16	0	Oregon	May 5	May 10	5
Idaho	April 25	April 28	3	Pennsylvania	May 3	May 7	4
Illinois	May 6	May 9	3	Rhode Island	May 9	May 12	3
Indiana	April 28	May 2	4	South Carolina	April 26	May 1	5
Iowa	May 5	May 7	2	South Dakota	April 28	April 28	0
Kansas	May 1	May 5	4	Tennessee	April 25	April 29	4
Kentucky	April 25	April 29	4	Texas	May 2	May 5	3
Louisiana	April 28	May 4	6	Utah	May 2	May 1	-1
Maine	May 6	May 8	2	Vermont	May 11	May 10	-1
Maryland	May 8	May 11	3	Virginia	April 28	May 2	4
Massachusetts	May 3	May 8	5	Washington	May 9	May 10	1
Michigan	May 8	May 12	4	West Virginia	April 25	May 1	6
Minnesota	May 13	May 14	1	Wisconsin	May 8	May 11	3
Mississippi	April 19	April 24	5	Wyoming	May 2	May 6	4

Source: Tax Foundation

Tax Freedom Day by State
Calendar Year 1991



Source: Tax Foundation

Tax Freedom Day from page 3

Freedom Day until May 26th this year, later than residents of any other state. The culprit is a combination of a heavy federal tax burden and high state/local taxes. District of Columbia taxpayers shoulder the next heaviest overall tax burden, followed by taxpayers in Delaware, Connecticut and Hawaii.

Mississippi will be the first state to finish paying for government this year—its Tax Freedom Day is April 24th. Alabama and Arkansas will follow on April 25th and 26th, and citizens of South Dakota, Idaho and Missouri will celebrate on April 28th.

Tax Freedom Day Outlook

Although the average American will work until May 8 to afford his tax bill, forfeiting over 35 percent of his total income in 1991, the government will spend all that money and more. It should be noted that Tax Freedom Day does not reflect the estimated \$318 billion in fed-

eral deficit spending for 1991. That will be felt through future increases in the tax burden and/or a weaker economy.

Working a record 128 days until May 8 to pay off the tax collectors may come as a shock to many Americans. However, the combined pressures of a persistent federal budget deficit, demands to expand funding for new and existing programs, budget crises in numerous states and the slowdown in income growth could easily make Tax Freedom Day even later on our calendars in future years.

Tax Bite in the 8-Hour Day

Another way to graphically express the tax burden's effect on the average worker's paycheck is the Tax Bite in the Eight-Hour Day. In 1991, Tax Foundation analysts estimate that the average worker will spend 2 hours and 49 minutes of an 8-hour day working to satisfy federal, state and local tax collectors—five minutes more each day than in 1990. One hour and 50 minutes will go to-

wards federal taxes while 59 minutes will be devoted to state and local taxes.

With a record-setting chunk of the day, 2 hours and 49 minutes, spent working for taxes, the average worker has less to spend on the rest of the family budget (see pie chart for breakdown and table 2 for historical data).

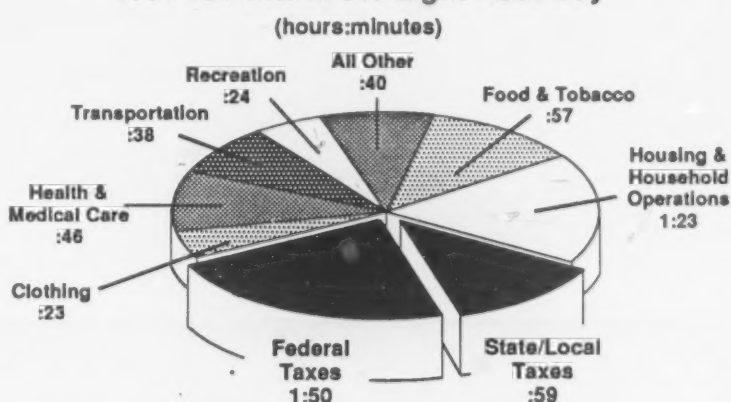
Table 2
Tax Freedom Day and
Tax Bite in the 8-Hour Day
Selected Calendar Years
1929 – 1991

Year	Tax Freedom Day	Tax Bite in the Eight-Hour Day (Hours:Minutes)
1929	February 9	1:52
1931	February 15	1:00
1933	March 5	1:24
1935	March 1	1:17
1937	March 6	1:24
1939	March 6	1:24
1940*	March 8	1:29
1941	March 17	1:40
1942	March 19	1:43
1943	April 6	2:06
1944*	March 30	1:58
1945	April 1	1:59
1946	March 31	1:57
1947	April 3	2:01
1948*	March 28	1:55
1949	March 24	1:48
1950	April 3	2:02
1951	April 10	2:11
1952*	April 10	2:12
1953	April 10	2:12
1954	April 6	2:05
1955	April 9	2:09
1956*	April 11	2:13
1957	April 13	2:14
1958	April 10	2:12
1959	April 14	2:16
1960*	April 17	2:22
1961	April 18	2:22
1962	April 18	2:21
1963	April 19	2:23
1964*	April 15	2:18
1965	April 15	2:17
1966	April 18	2:21
1967	April 20	2:24
1968*	April 25	2:32
1969	May 1	2:38
1970	April 28	2:34
1971	April 25	2:31
1972*	April 29	2:36
1973	April 29	2:36
1974	May 3	2:41
1975	April 28	2:35
1976*	May 1	2:40
1977	May 3	2:41
1978	May 3	2:41
1979	May 3	2:41
1980*	May 1	2:39
1981	May 4	2:43
1982	May 3	2:41
1983	April 30	2:38
1984*	April 28	2:36
1985	May 1	2:38
1986	May 2	2:40
1987	May 4	2:43
1988*	May 3	2:43
1989	May 4	2:44
1990	May 5	2:44
1991e	May 8	2:49

Source: Tax Foundation.

* Leap year makes Tax Freedom Day appear a calendar day earlier.

1991 Tax Bite in the Eight-Hour Day



Tax Bite in the Eight-Hour Day

1990-1991

	(hours:minutes)	
	1990	1991
Total Taxes	2:44	2:49
Federal	1:47	1:50
State and Local	:57	:59
Total Personal Consumption Expenditures	5:16	5:11
Housing and Household Operations	1:26	1:23
Food and Tobacco	:58	:57
Health and Medical Care	:44	:46
Transportation	:39	:38
Recreation	:24	:24
Clothing	:24	:23
All Other	:41	:40
8-Hour Day	8:00	8:00

Survey Reveals Record State Tax Increases Slated For FY1992

A forthcoming Tax Foundation survey of the 50 states reveals that nearly half of them will wrestle with record deficits in FY1992 and plan to combat them with new and higher taxes. Of the \$11.8 billion in new taxes already proposed or passed, five states account for 83 percent of the revenue: California, Connecticut, New Jersey, Pennsylvania and Texas. Since they all have constitutional or statutory balanced budget requirements, the tax-raising and budget-cutting fights of the past several years may prove to have been skirmishes before the battle that's shaping up in FY'92.

Two symptoms of the nationwide

Proposed Fiscal 1992 Net Tax Increases by Major Type of Tax (\$ Millions)

Tax	Net Amount
Personal Income	\$6,487.0
Business	2,459.4
Sales and Use	629.5
Motor Fuel	724.6
Cigarette and Tobacco	423.2
Alcoholic Beverage	205.6
Property	-560.0
Miscellaneous	1,193.5
Total	\$11,762.8*

* Includes \$200 million from Illinois that will be a combination of personal income and business.
Source: Tax Foundation.

recession, low corporate profits and sluggish personal consumption, have made a mockery of state revenue estimates. While some states plan to limp by with measures such as accelerating tax collections, increasing fees, eliminating tax credits and extending temporary tax hikes, the magnitude of anticipated budget shortfalls has caused many to tap the big three state revenue sources — sales, individual and corporate income taxes — with a heavy emphasis in some states on tobacco excises.

On the personal income tax front, more than a third of the states have tax

State Tax Picture Augurs Poorly for Future Tax Freedom Days

As stories in the *Boston Globe*, the *Detroit Free Press*, on CNN Headline News, ABC's World News This Morning, and CNN's Crossfire attest, the public is interested in a comprehensible measure of our tax burden. That's what Tax Freedom Day is all about.

Due to the way governments at all levels nickle and dime the taxpayer, it is nearly impossible to grasp the extent of all taxes. Most Americans are astonished to hear that they will have to work 128 days — from January 1 to May 8 — just to pay taxes. This labor for government is the longest ever, and Tax Freedom Day's three-day increase over 1990 is the biggest jump since 1976.

Of course, federal taxes play the lead role in the growing tax burden, but I'd like to focus on the sharp increases in state and local taxes.

Everyone knows the old saying that "New York is a nice place to visit, but you wouldn't want to live there." Unfortunately for taxpayers who already live there, Tax Foundation research shows New Yorkers paying the highest taxes in the country. They won't celebrate Tax Freedom Day until May 26th this year — two and a half weeks later than the national average — thanks in great measure to state and local taxes that are higher than any other state's.

Is New York lowering its taxes in recognition of its citizens' heavy burden? Just the opposite: a scheduled personal income tax reduction was cancelled last year due to a budget shortfall. And New York is not the only state facing a budget crisis and reacting by raising taxes. The Tax Foundation's fiscal survey of the 50 states reveals that over half the states are planning new and higher taxes. California, Connecticut, New Jersey, Pennsylvania, and Texas, have all proposed or passed large tax increases for FY'92.

As taxpayers contemplate new state-level taxes, a snapshot of their total tax burden, even as simple as the one that Tax Freedom Day state-by-state provides, enables them to make more informed decisions. And educating taxpayers, helping them make more informed decisions about taxes, is what the Tax Foundation is all about.

hikes on the drawing board that will net \$6.6 billion. Connecticut and Tennessee, which currently tax primarily interest and dividend income, are eyeing broad-based taxes. Texas, one of only seven states which share the distinction of having no individual income tax, has plans that would reduce this select group to six. New Jersey and Rhode Island enacted increases in June 1990 and February 1991 respectively, effective in FY'92, and two more states, Kansas and Vermont, are seeking rate increases. Arkansas and South Carolina are alone in proposing reductions in personal income taxes by either narrowing the base or lowering the rate.

Businesses are the next most popular target for state tax raisers this year as 19 states plan to extract \$2.5 billion in FY'92 revenue from them. Five states —

Arkansas, Kansas, Kentucky, New Hampshire, Pennsylvania, Minnesota, Oregon, and Wisconsin — are seeking higher rates or broader bases. Rhode Island has imposed an 11 percent business corporation surtax for investment companies in addition to the basic business corporation tax, and New York joins Illinois in considering permanent extensions of expiring increases. Texas would replace the corporate franchise tax with an 8 percent income tax.

On the other hand, Arkansas, Connecticut, and West Virginia are planning reductions in corporate rates. Connecticut would replace the 20 percent corporate surcharge with an 11.5 percent effective rate.

For data on sales taxes, excise taxes and other changes, see accompanying tables at left and on page 6.



Dan Witt
Executive Director

Fiscal 1992 Revenue Proposals by Type of Revenue and Net Increase or Decrease (\$Millions)

State	Personal Income Taxes	Business Taxes	Sales and Use Taxes	Motor Fuels Taxes	Tobacco Taxes	Alcohol Taxes	Property Taxes	Miscellaneous Taxes	Total Net Revenue
Alabama									
Alaska									
Arizona									
Arkansas	-14.2	12.0	159.0	86.8	3.0				246.6
California*	80.0	290.0	384.0			190.0		823.0	1,767.0
Colorado									
Connecticut	2,073.0	-55.0	-933.0	30.5				-526.0	589.5
Delaware									
Florida									
Georgia	-30.0								-30.0
Hawaii				67.1					67.1
Idaho				36.0					36.0
Illinois*									200.0
Indiana									
Iowa	71.0								71.0
Kansas*	6.5	109.0	13.3						128.8
Kentucky	350.0	45.0	200.0						595.0
Louisiana									
Maine									
Maryland	32.0		45.6		12.5				90.1
Massachusetts									
Michigan									
Minnesota	36.1	2.7			79.7	11.0		-0.1	129.4
Mississippi									
Missouri*		85.0			21.0				106.0
Montana	10.0				2.8				12.8
Nebraska									
Nevada		120.0							120.0
New Hampshire		8.0							8.0
New Jersey*	1,335.0	1,040.0					-560.0		1,815.0
New Mexico	6.3	10.0	11.0						27.3
New York	400.0	45.0	81.0	500.0				90.0	1,116.0
North Carolina*			242.0			4.6			246.6
North Dakota					1.5			1.0	2.5
Ohio*			97.0						97.0
Oklahoma									
Oregon	4.0	8.0							12.0
Pennsylvania		334.0	288.0		300.0			773.0	1,695.0
Rhode Island	101.2	5.0		4.2					110.4
South Carolina*	3.3							1.5	4.8
South Dakota									
Tennessee									
Texas	2,000.0	400.0							2,400.0
Utah									
Vermont	22.8		38.1		2.7				63.6
Virginia									
Washington									
West Virginia*		-2.2						-1.5	-3.7
Wisconsin		2.9	3.5					24.6	31.0
Wyoming									
Dist. of Columbia								8.0	8.0
Totals	\$6,487.0	\$2,459.4	\$629.5	\$724.6	\$423.2	\$205.6	(\$560.0)	\$1,193.5	\$11,762.8

California - Some local revenues included. Miscellaneous revenues include revision of license fee depreciation schedule.

Illinois - Proposal plans to indefinitely extend expiring increases in personal and corporate income tax rates.

Kansas - Revenues of \$109 million are net of \$8.5 million loss in revenues from a change in retirement income taxation.

Missouri - Changes in individual income and sales taxes also proposed.

New Jersey - FY92 revenue impact estimates from tax increase in 1990. Homestead rebates provide property tax relief.

North Carolina - 1/2 cent local options sales tax to replace current state appropriations for local governments. Alcohol revenue due from license fee increase.

South Carolina - Personal income revenue includes a \$6.7 million reduction in revenues from phasing down the income tax rate under past legislation.

Revenues will increase \$9.4 million due to the repeal of the capital gains exclusion.

Ohio - Revenues generated from the elimination of auto sales tax exemptions, capping of revenues distributed to local governments, and the elimination of discounts for early sales tax payments.

West Virginia - Reductions in corporate income tax rate and utility tax are part of a phase down reductions from earlier legislation.

Source: Tax Foundation. Data compiled from state survey of revenue departments, legislative officials, and governors' offices.

Rebuilding the U.S. Industrial Base: The Role of Tax Policy in Economic Growth

Wednesday, May 22, 1991 at The Washington Court Hotel in Washington, D.C.

Registration/Light Fare
Conference Sessions
Cocktail Reception

12:00 p.m.
12:30 - 5:00 p.m.
5:15 p.m.

Atrium Room
Atrium Room
Sagamore Hill

- Direct any questions about the conference to Gretchen Georgiadis at 202-863-5454. FAX 202-488-8282.
- Reservations should be received by Monday, May 20, 1991.
- The Washington Court is located at 525 New Jersey Ave., N.W., Washington, D.C. 20001-1527. (202)-628-2100.

12:00 Registration (light fare)

12:30 Welcome: Dan Witt, Executive
Director, Tax Foundation

Keynote Address: Lawrence B. Lindsey,
Special Asst. to the President for Policy
Development & Assoc. Director for Domestic
Economic Policy

1:00 *Assessing Pro-Growth Tax Policies
for 1991 and Beyond*

Moderator: Leif H. Olsen
President

Leif H. Olsen Associates, Inc.
Former Chief Economist - Citibank

Congressman Richard T. Schulze (R-PA)
House Ways and Means Committee

William C. Dunkelberg
Dean of the School of Bus. & Management
Temple University

Van McMurtry
Chief Counsel - Majority
Senate Committee on Finance

Charles Hahn
Assistant Tax Director
Dow Chemical Company

2:15 *Are U.S. Tax Policies Impeding
Transborder Investment?*

Moderator: Catherine Porter
Partner
Miller & Chevalier

Congressman Robert T. Matsui (D-CA)
House Ways and Means Committee

Alan J. Lipner
Sr. Vice President - Corporate Taxes
American Express Company

Marlin Risinger
Associate International Tax Counsel
Department of the Treasury

Edmund K. Harding
Manager, Tax Planning & Litigation
Xerox Corporation

George N. Carlson
Director of the Economic Analysis Group
Arthur Andersen & Co.

3:30 Coffee Break

3:45 *Rejuvenating Service Sector
Strength (Financial/Real Estate/
Insurance/Retail)*

Lawrence A. Kudlow
Chief Economist
Bear Stearns & Company

Henry Ruempler
Director of Tax & Accounting
American Bankers Association

Jane G. Gravelle
Senior Specialist in Economic Policy
Congressional Research Service

5:15 Cocktail Reception

Reservation Form

Name: _____

Company: _____

Address: _____

City: _____ State: _____ Zip: _____

Telephone: _____ FAX: _____

**Please return reservation
form with payment to:**

Tax Foundation
470 L'Enfant Plaza, S.W.
Suite 7400
Washington, DC 20024
FAX: 202-488-8282
Attn: Gretchen Georgiadis

Conference Fee: Member/\$100, Non-Member/\$125

Congressional and Executive Branch Staff and Media complimentary.

A check made payable to the **Tax Foundation** in the amount of \$ _____ is enclosed.

Foundation's Message Heard Across the Nation

St. Louis Membership Briefing Features Foundation Co-Chairman James C. Miller III

Monsanto Company, a Tax Foundation member since 1943, hosted the latest in a series of luncheons for Foundation members and guests at the St. Louis Club on April 2. Tax Foundation co-chairman James C. Miller III spoke to the group of chief financial officers and senior tax executives.

Miller, director of the Office of Management and Budget from 1985 to 1988, gave an interview after the luncheon about his federal budgeting experiences to *St. Louis Post-Dispatch* business reporter David Nicklaus, who featured the interview in his April 5 column on the front page of the business section.

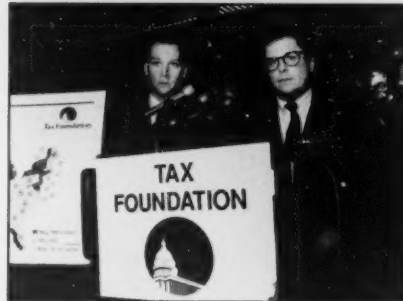
Miller predicted that the five-year budget plan signed into law last October by President Bush would break down in fiscal year 1993. In that year, deep cuts are scheduled to go into effect, after two years of steep increases in federal taxing and spending.

The briefing included representatives from such firms as Emerson Electric, General Dynamics, ITT Financial Corp., The May Cos., Mercantile Bancorporation, Ralston Purina, Southwestern Bell, Union Electric, and United Van Lines.

Tax Freedom Day Press Conference in Washington, DC



Dan Witt uses the Foundation's state-by-state Tax Freedom Day analysis to explain how citizens face different tax burdens.



Dan Witt (r.) and Paul Merski present Tax Freedom Day for 1991. This popular measure of the tax burden shows average taxpayers paying over 35 percent of their income in taxes.

Dan Witt Is Foundation's New Executive Director

Dan Witt, vice president of the Tax Foundation since 1989, will assume the day-to-day leadership of the organization as its executive director.

Prior to joining the Tax Foundation, Mr. Witt was Director of Membership with Citizens for a Sound Economy, a 250,000-member Washington-based public interest group. He received his MBA from Western Michigan University.

Mr. Witt replaces Wayne Gable who has served as the Foundation's president since September 1989.

Tax Features

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Tax Features

Foundation Seminar Examines Tax Policy's Impact on Economic Growth

Over one hundred tax executives, congressional staff members and Administration officials gathered May 22nd in Washington, D.C. for the Tax Foundation's seminar "Rebuilding the U.S. Industrial Base: The Role of Tax Policy."

James C. Miller III, co-chairman of the Tax Foundation and former Director of the Office of Management and Budget under President Reagan, introduced keynote speaker Lawrence



Lawrence B. Lindsey, special assistant to the President for economic policy development, and a Federal Reserve Board nominee, leaves the seminar surrounded by reporters after his keynote address.

B. Lindsey, special assistant to the President for domestic economic policy, with an admonition to the press that his remarks had to be off the record due to his pending confirmation to the Federal Reserve Board.

The first panel on pro-growth tax policies, moderated by economist Leif H. Olsen, included speeches by Congressman Richard T. Schulze (R-PA), William C. Dunkelberg of Temple University, and Charles Hahn of Dow Chemical Company.

The second panel on U.S. tax policies' impeding transborder investment was chaired by Catherine Porter of Miller & Chevalier. Speakers included Alan J. Lipner of American Express Company, Marlin Risinger from the Treasury Department, Edmund K. Harding of Xerox Corporation, and George N. Carlson of Arthur Andersen & Co.

See Seminar on page 7

Bring Order to Research and Development Tax Policy



Senator John Chafee

Concern about the ability of U.S. businesses to compete with foreign firms has been increasing in recent years. International competitiveness has become one of the top concerns of Congress, and rightly so. Given the importance of this issue, government policies, especially tax policies, should be carefully scrutinized to ensure they do not hinder our ability to compete.

One area of tremendous importance in today's competitive environment is research and development (R&D) which leads to technological innovation. Since 1929, more than two-thirds of our economic growth has resulted from technological innovation. The nations winning the competitiveness race are those that recognize the importance of advanced technology — because it results in new marketable products and more efficient production and manufacturing. These countries work to attract companies that will establish research and development facilities within their borders.

To achieve greater economic competitiveness we must not impede U.S. investment in research and development. With this goal in mind, Senator Baucus and I are introducing legislation to help U.S. business regain its competitive edge. Our bill will change a tax policy which actually impedes our ability to compete, and may, in fact, encourage the export of R&D activities and important technological advances.

Yet, the U.S. is falling behind in its development of new technologies. One of the reasons for this decline is the research allocation rules contained in Treasury Regulation Section 1.861-8, issued in 1977. This is confirmed by a

See Chafee on page 2

Senator John Chafee, Republican from Rhode Island, serves on the Senate Finance Committee.

The opinions expressed in the Front Burner are not necessarily those of the Tax Foundation. Editorial replies are encouraged.



Tax Foundation

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recommendation in a report by the Council on Competitiveness to "place a permanent moratorium on Treasury Regulation 1.861-8, . . . This regulation increases the effective rate of U.S. taxation of R&D in the United States."

"Stable tax policies with regard to research and development are extremely important. Without stability, we cannot expect our major investors in R&D to make the long-range plans that are critical to some of our most promising research efforts."

The 861-8 regulations require U.S. companies with foreign operations to allocate a portion of their domestic R&D to their foreign income. Of course, foreign countries do not allow our companies to use the cost of research performed in the U.S. as a deduction from the income earned in the foreign country. The net effect is to increase the worldwide tax liability of the companies performing R&D in the U.S., encouraging American companies to locate their R&D efforts abroad.

While the regulations may be founded on what some would consider valid technical tax principles, it is difficult to understand why the United States would adopt policies that discourage the pursuit of domestic R&D. Shortly after the regulations were issued, Congress recognized that they represented poor tax policy and placed a moratorium on their implementation. Congress has renewed this moratorium seven times. It's time to put an end to the controversy surrounding Section 861 — over a decade of uncertainty is enough.

Stable tax policies with regard to research and development are extremely important. Without stability, we cannot expect our major investors in R&D to make the long-range plans that are critical to some of our most promising research efforts. With permanent reform of Section 861, we have an opportunity to

both change a misguided policy and to increase long-term R&D investment.

Efforts to reform Section 861 have often been misinterpreted. It has been alleged that reform is some type of tax break — I assure you that is not the case. Section 861 is a penalty on domestic R&D, because it requires U.S. R&D performers to engage in an accounting fiction that leads to double taxation and increases their worldwide tax liability. Removal of this penalty simply allows American companies to be treated like their counterparts all over the world.

It has also been alleged that reform of section 861 will only benefit multinational corporations. In a way, this is true — a U.S. company must have foreign operations in order to be penalized by Section 861. However, small companies that conduct U.S. R&D and sell abroad are also penalized by Section 861, just like the larger corporations. There are hundreds of small companies that will be burdened less, and made stronger and more competitive, if the section 861 penalty is removed.

"Shortly after the regulations were issued, Congress recognized that they represented poor tax policy and placed a moratorium on their implementation. Congress has renewed this moratorium seven times. It's time to put an end to the controversy surrounding Section 861 — over a decade of uncertainty is enough."

Fortunately, President Bush has led the way toward settling this issue with a proposal to extend the current moratorium for one additional year. However, the President's proposal does not go far enough. These pro-competitive policies must be made permanent to encourage new technological innovation by our companies, to improve American tax policy, and promote American competitiveness.

Property Taxes Up \$10.3 Billion in FY'89, Hitting \$142.5 Billion

State and local property tax revenues increased \$10.3 billion in fiscal year 1989, up 7.8 percent from FY'88. This collection of \$142.5 billion in property taxes in 1989 is more than double the \$65 billion collected a decade ago, and revenues from property taxes currently represent over 30 percent of total state/local revenues.

This decade of prodigious increases has spurred taxpayers in some states to demand lower property taxes, though the relief has often been accompanied by individual and corporate income tax hikes. Compared to the 7.8 percent growth rate in property taxes in FY'89, individual and corporate taxes rose 10.7 percent and 9.2 percent respectively.

Major Source of Local Revenues

Property tax remains the leading tax revenue source for local governments, providing 74 percent of the FY'89 total. Local property tax revenue rose \$9.9 billion from FY'88 to FY'89, reaching a total of \$137 billion for 1989. Although forty-eight states impose some type of property tax, the levies apply to a narrow base and furnish under 2 percent of total state monies. While the other eight states do not impose a property tax, their localities levy property taxes that provide an average of 27 percent of total state and local tax revenues.

Growth Per Capita and Per \$1,000 of Personal Income

While total property tax revenues have grown by 119 percent over the past ten years from \$65 billion to \$142.5 million, per capita growth in property taxes has risen at a slower rate, 95 percent, from \$295 in 1979 to \$574 in 1989. When related to personal income, property taxes per \$1,000 of personal income have declined slightly, from \$38 to \$35 per \$1,000 of personal income.

Per Capita

Taxpayers in four states and the District of Columbia paid over \$1,000 each in property taxes in 1989. States

See Property Taxes on page 3

Property Taxes from page 2

with the highest per capita burden are Alaska (\$1,257), District of Columbia (\$1,177), New Hampshire (\$1,058), New Jersey (\$1,056), and Connecticut (\$1,003). States with the lowest per capita property

tax burden were Alabama (\$148), New Mexico (\$180), Arkansas (\$211), Kentucky (\$228), and West Virginia (\$237). Residents with the highest per capita property tax collections paid an average of \$909 more than citizens in the lowest per capita states.

Property Tax Collections by State
Per Capita and Per \$1,000 of Personal Income
Fiscal Years 1979 and 1989

State	Per Capita Property Tax				Property Tax Per \$1,000 of Pers. Income			
	Amount		Percent Change	Rank 1989	Amount		Percent Change	Rank 1989
	1979	1989			1979	1989		
Total	\$295	\$574	94.6%	-	\$38	\$35	-7.5%	-
Alabama	73	148	104.1	51	12	12	-0.4	51
Alaska	826	1,257	52.2	1	76	66	-12.8	1
Arizona	353	600	70.0	23	50	41	-18.1	19
Arkansas	125	211	68.0	49	21	17	-17.3	48
California	266	543	104.0	27	30	30	-2.1	33
Colorado	326	635	94.6	19	42	39	-7.3	22
Connecticut	456	1,003	119.8	5	51	44	-15.4	15
Delaware	165	276	67.1	44	19	16	-17.6	49
Florida	247	549	122.3	24	34	34	1.0	27
Georgia	209	444	111.8	33	31	30	-6.2	34
Hawaii	191	335	75.9	39	23	20	-13.3	43
Idaho	245	396	57.5	37	36	31	-14.4	31
Illinois	350	657	88.1	18	39	38	-4.3	23
Indiana	247	490	94.6	30	32	32	0.6	29
Iowa	339	624	84.1	20	42	43	0.5	17
Kansas	357	617	72.6	21	46	39	-13.8	21
Kentucky	131	228	74.8	48	20	18	-10.6	47
Louisiana	102	241	137.8	46	15	20	27.6	46
Maine	303	666	120.2	16	48	45	-7.4	13
Maryland	276	546	97.8	25	33	28	-13.9	36
Massachusetts	546	743	36.1	10	69	36	-47.9	24
Michigan	376	764	103.3	9	44	46	4.3	11
Minnesota	311	659	111.8	17	40	40	0.3	20
Mississippi	138	291	111.7	43	25	26	4.3	38
Missouri	205	318	54.9	41	28	21	-26.5	42
Montana	408	679	66.4	15	61	53	-12.7	6
Nebraska	389	698	79.4	14	52	47	-7.9	10
Nevada	355	386	8.8	36	40	23	-41.9	39
New Hampshire	426	1,058	146.5	3	59	56	-5.8	3
New Jersey	506	1,056	108.7	4	58	48	-16.7	9
New Mexico	131	180	37.0	50	20	15	-28.5	50
New York	482	909	92.9	6	58	48	-17.2	8
North Carolina	163	322	97.7	40	25	23	-8.4	40
North Dakota	257	441	71.4	34	36	34	-5.9	26
Ohio	260	476	83.0	31	33	31	-6.9	32
Oklahoma	149	267	78.9	45	21	20	-5.1	45
Oregon	366	795	117.4	8	47	54	16.5	4
Pennsylvania	230	467	103.4	32	30	29	-2.5	35
Rhode Island	399	737	84.7	11	53	44	-17.3	14
South Carolina	151	353	134.3	38	24	28	14.8	37
South Dakota	343	544	58.7	26	50	43	-14.3	16
Tennessee	155	296	90.9	42	24	22	-9.6	41
Texas	274	613	123.8	22	36	42	16.4	18
Utah	230	420	82.1	35	37	35	-5.3	25
Vermont	360	729	102.4	12	56	48	-12.8	7
Virginia	223	541	142.7	29	29	31	5.8	30
Washington	308	542	76.0	28	38	34	-10.6	28
West Virginia	131	237	81.7	47	20	20	0.5	44
Wisconsin	346	710	105.2	13	46	46	-1.1	12
Wyoming	513	870	69.6	7	63	63	0.4	2
Dist. of Columbia	323	1,177	263.8	2	32	54	69.7	5

Source: Department of Commerce; and Tax Foundation computations.

In terms of the decade's growth rate in per capita property taxes, nineteen states and the District of Columbia more than doubled their collections. The District of Columbia led the nation with a 264 percent growth rate, with New Hampshire and Virginia following behind at 149 percent and 143 percent respectively. None of the fifty states reported a decline in per capita property collections between 1979 and 1989.

Per \$1,000 of Personal Income

When comparing property taxes per \$1,000 of personal income, Alaska (\$66), Wyoming (\$64), and New Hampshire (\$56) led states with the highest collections. The lowest property tax burdens by this yardstick were in Alabama (\$12), New Mexico (\$15), and Delaware (\$16).

Between 1979 and 1989, thirteen states and the District of Columbia experienced increases in property taxes in

This decade of prodigious increases has spurred taxpayers in some states to demand a lighter property tax burden, though the relief has often been accompanied by individual and corporate income tax increases.

relation to personal income. The District of Columbia reported the largest increase of 70 percent, from \$32 in 1979 to \$54 in 1989. Massachusetts and Nevada realized the sharpest reduction in the property tax/income ratio during the decade, down 48 percent and 42 percent respectively.

Outlook

A recent Tax Foundation survey of the fifty states revealed that many states are re-examining property taxes. Kansas, Michigan, New Jersey, Oregon, and Wisconsin have already placed property tax reform at the top of their FY'92 agenda. Many reforms are efforts by the states to balance the increase in other taxes. Taxpayers may witness reforms in property taxes for FY'92, which would include tax relief plans in the form of credits and rate reductions. ■

Uniform Business Tax Would Revamp U.S. Corporate Taxes

On April 30, 1991, Tax Foundation economist Paul G. Merski interviewed Congressman Richard T. Schulze on his proposal for a Uniform Business Tax which would replace the current corporate income tax and the employer portion of the Social Security tax with a nine percent tax on business receipts less the cost of goods sold.

In the tradition of the Foundation's serving as a forum for objective debate on key tax policy issues, business leaders from a cross-section of American industry respond to the congressman's proposal on page 6.

Q Currently, there seems to be a consensus that the U.S. corporate tax system has become the most complex in the world and costs almost as much to comply with as it raises in revenues. What is the "Schulze Solution" and will it simplify our complex corporate tax system?

A There are several excellent studies which show that it costs the business community almost as much to maintain tax records and fill out corporate tax forms, as is raised in revenues. One several years ago showed definitively a cost of \$.66 for each dollar collected. Since that time we've had the Tax Reform Act of 1986, we've had TEFRA, DEFRA, OBRA, COBRA, TAMRA, OBRA II — a virtual alphabet soup of so-called tax reform or tax revisions. Unfortunately, if anything, the tax code has become much more complex. My answer to this problem is the Uniform Business Tax, or UBT, and one of my goals with the proposal is simplification. As a matter of fact, what we're striving for is to greatly reduce the \$90-100 billion it now costs corporate America — the business community — just to comply with the corporate income tax. What I would like to see is a tax system that would eliminate this huge dead-weight cost of tax compliance and administration both for the government and the business community.

Q Taxpayers, as you pointed out, have already witnessed 14 major tax bills enacted over the past decade, and yet we are still facing record budget deficits. How would your Uniform Business Tax legislation address the deficit without increasing the record high tax burden on the American taxpayer?

A The Uniform Business Tax will not increase the tax burden on American taxpayers. The UBT will substitute a flat 9 percent tax on gross receipts less the cost of goods sold for the existing corporate income and payroll tax. Our goal is to raise just about the

A I'm glad you asked that question because it's very difficult trying to explain that the UBT is not a VAT. In one of the brochures we send to people who ask us about it, we have made up a list of comparisons between the VAT, the UBT, and the corporate income tax. I will try to briefly compare the VAT with the UBT. Let me first say that one of our major goals was, and is, tax simplification. With a standard European type VAT, at every level of production there is an additional tax, an additional transaction, paperwork, taxes paid, credits given, slips back and forth, audits called for — it is extremely complex. Or



Congressman Richard T. Schulze (right), a member of the House Ways and Means Committee, is interviewed by the Tax Foundation's director of fiscal affairs, Paul G. Merski.

same amount as corporations now pay. The border aspects, or the territorial aspects, of this tax, however, being collected at the border and rebated on goods sold overseas, would bring in approximately \$50 billion of additional revenues, which could make a meaningful contribution toward deficit reduction.

Q The idea of implementing a value-added type tax has been around for decades but has never received much support from the business community. How does your UBT differ from a value-added tax?

let me turn that around and say, it is complexity in the extreme. One of the cries against a standard European style VAT has historically been its complexity. My proposal will hopefully achieve the other extreme of simplicity. That is a major difference between the VAT tax and the UBT. Normally, a VAT, when applied, is added on top of existing taxes. The UBT would not be added, but would be used in place of existing taxes. It is not a multi-staged sales tax like the VAT. I believe that the business community would pay this tax, which is paid in

total at the end, rather than a standard add-on European type VAT. Even in retail stores they have the price plus a VAT and so it's very obvious that it's added on top. I think the UBT is not only simpler, but it's not passed on totally to the consumer. So two of the key differences between them are the incidence of the tax and the method of calculation. The difference between a credit for a VAT and a deduction from the UBT is a large difference and I think that it makes the UBT much preferable.

Q Given our global economic environment, the impact that U.S. tax policies have on transborder investment cannot be ignored. How would the UBT impact our competitiveness with major trading partners, and is it consistent with international taxation practices?

A It certainly is consistent with international tax practices and that's been one of our major objectives. The UBT is a GATT-legal tax which has a high degree of consistency with our major trading partners without really changing our entire structure and making it like the European type system. The border applicability of this tax makes it dovetail very well with all of our major trading partners, all of whom have some form of border tax or territorial tax. So in international trade, it has a tendency to level the playing field. Products made in the United States today have built into them all of the costs of government: local, state, and federal government, through the various taxes that are paid by the producers. When these products are shipped, for instance, to a European country, as it crosses the border, the cost of their government is added to that product so that not only is the cost of our government involved in the product, but the cost of the ultimate user country is included as well. When that same product is made in a European country and shipped to the United States, the tax which has been paid is rebated and, as a consequence, their cost of government is not involved. As it comes across the border our cost of government is not placed into it, which puts us at an economic and competitive disadvantage. And so I think that the UBT is not only consistent with our international obligations and the practices of our trading partners, but helps the domestic producer.

Q A common complaint of U.S. manufacturers is the high cost of capital relative to other industrialized nations. Would your UBT help reduce capital investment costs here in the U.S.?

A My belief is that it will allow a dramatic reduction in the cost of capital because the UBT allows immediate expensing of capital goods. Our goal is to lower the cost of capital and, in fact, put an incentive in for expansion, modernization, and improving plant facilities and productivity. I think we can achieve that with the UBT.

Q Many taxpayers fear that new tax legislation automatically translates into higher taxes. Your UBT legislation plans to raise an additional \$50 or \$60 billion per year — does that mean higher taxes and increased government spending?

A I'm convinced that it will not mean higher taxes and higher spending. There exists a transfer pricing problem in our country when some foreign corporations operating in the U.S. are making inordinate profits at home and avoiding paying taxes in the United States. The border aspects of the UBT would cure a portion of the transfer pricing problem. If products coming into America now have been over-priced somewhat, or their prices are not in line with other markets elsewhere, the difference will be absorbed immediately by the shipping country or company with little impact on the domestic prices. In my opinion, in a competitive environment, the tax would not be passed on to domestic consumers, but would be mainly paid by foreign corporations and companies.

Q In addition to replacing the corporate income tax, the UBT also replaces the existing employer-paid portion of the FICA payroll tax. Will this aspect jeopardize revenues going into the Social Security Trust Fund?

A That was the first question the AARP (American Association of Retired Persons), who keep a very close eye on such things, asked when we sat down with them and explained the UBT. We explained to them that the employers' portion of FICA will be paid in a preferential manner just as it is today. That seemed to satisfy them, and the answer is that it will not make any change in the way FICA is handled.

Q With such a broad-based tax as the UBT, what would prevent the government from extracting huge amounts of additional revenue simply by raising the rate 1 or 2 percent every few years above the 9 percent you have outlined?

A That's always been a fear with any tax, and I think, quite frankly, a justifiable one with today's budget situation and tax structure. Because our current corporate tax code is so complex, we tend to pick winners and losers and can pick off the industries and portions of industries to tax. With the UBT's broad-based relatively flat system, you would impact every business entity in the United States, large and small, if you were to make a change. I don't think that would be done either lightly or easily. As a matter of fact, I think it would pose one of the most difficult political problems for anyone who thought they could raise this tax in a cavalier off-hand manner. Therefore, I think just the opposite — that it would be an extremely difficult tax to increase.

Q What reaction has the UBT received from your colleagues here on Capitol Hill and from the business community around the nation?

A As with any tax proposal, the initial reaction is skepticism. But as we respond to concerns, take a closer look at the numbers, and view the product with a careful eye on what a tax structure should do to set sound tax policy, we're getting more and more acceptance. The proposal is not hard to understand or complicated, but the standard reply from many businesses, after what they've been through for the last decade and a half, is, "No, don't change anything." But when we sit down with them and discuss where we're going as a nation, how we're going to get there, what their vision of the United States is in a very competitive world, the UBT becomes more attractive. It's really a question of whether we're going to be able to compete in a global economic environment, not only in the service industries, but in manufacturing as well. We're getting more and more of the reaction of Lee Iacocca, chairman of Chrysler, for instance, who thinks that it's imperative that we make such a change and put sound tax policies in effect. ■

Tax Policy Community Responds to the Uniform Business Tax

The UBT: A VAT By Any Other Name

Michael Altier

Vice President & Legislative Counsel
National Retail Federation

Congressman Schulze has distributed among various business groups a proposal calling for a 9 percent Uniform Business Tax (UBT) that would replace the current business income taxes and the employer's portion of the FICA payroll tax.

Although proponents of the UBT wish to characterize it as a revamped border-adjustable business tax system, we at the National Retail Federation believe the UBT is a form of value-added tax, and in recent House Ways and Means Committee hearings, Members referred to "border-adjustable taxes" and

We believe the UBT is a form of value-added tax . . . [its] disadvantages are as valid today as they were twenty years ago . . . regressivity, inflationary impact, and potential complexity.

"value-added taxes" interchangeably. Thus, we must presume that any legislation in this area will be a variation of a value-added tax.

Over the years, retailers have consistently opposed various forms of a value-added tax, and its disadvantages are as valid today as they were twenty years ago. These include regressivity, inflationary impact, and potential complexity.

Congressman Schulze points to the UBT's qualification as a border-adjustable tax under GATT as a major advantage. This characteristic would seem to encourage exports while making imports more expensive. Additionally, the UBT claims to export \$60 billion of tax liability to foreign entities while leaving the U.S. business taxpayer's liability revenue neutral. We find it hard to believe that foreign suppliers will absorb such a significant tax increase — most of the additional cost on imports will be passed

through to the consumer.

The UBT is a radical proposal in terms of changing a tax system that has evolved over the last 70 years. We maintain that until sufficient economic studies and other testing of such a proposal can be done to determine the true impact on the U.S. economy, such a proposal is extremely dangerous and cannot be endorsed. Although the current tax system does have its faults and complexities, it has served the country well. This is not to say that changes are not warranted, but let us first try to work within a system where the economic outcome is more predictable.

The UBT: Fairness and Simplification in One

George T. Esherick

Vice President, Government Relations
American Iron and Steel Institute

Congressman Schulze's UBT proposal is a good addition to the debate over constructing a more competitive U.S. tax system. To be competitive in the 1990s and beyond, the U.S. needs fiscal policies that address the anti-competitive nature of our present business tax system. To accomplish this, we need to totally reform the way in which commerce is taxed in the U.S. As such, the American Iron and Steel Institute favors the consideration of a broad based border-adjustable tax as a substitute for the current business tax system and as a vehicle for providing investment and

[We] favor the consideration of a broad based border-adjustable tax as a substitute for the current business tax.

savings incentives. Such a tax would be levied on imports and rebated on exports, thus improving the competitiveness of domestically produced goods both in the U.S. and overseas markets.

A properly constructed, border-adjustable tax would create a broader and fairer tax system which would also be less complicated. It would help enhance U.S. savings and investment; not disad-

vantage one industry or region over another; be revenue neutral for all U.S. taxpayers; simplify the tax code; and hold promise to reduce the federal budget deficit without further eroding U.S. competitiveness.

Be Wary of Trading Taxes

Norman B. Ture
President

Institute for Research on the
Economics of Taxation

In the abstract, the UBT — a subtraction-method value added tax — is superior to the existing business income taxes in many important respects. It is neutral in its effect on the use of production capability for capital formation compared with consumption and with respect to the use of labor and capital services in production. Because the UBT would apply only to value added originating in domestic production, its replacement of business income taxes would contribute

The UBT would present a very great risk of accelerating growth in federal spending.

to improving the competitive position of American businesses in the world market place.

The most important function of a tax is to inform the citizens about the cost of government. To perform this function effectively, a tax must be imposed directly on the largest possible number of real persons. Taxes on business entities fail this test because their burden is hidden from the real people who ultimately pay them. In this respect, the UBT would be no better than the corporate income tax it is intended to replace. Because the UBT would also be a much more potent revenue raiser than business income taxes, its adoption would present a very great risk of accelerating growth in federal spending, thereby canceling any economic benefits it might otherwise provide. We should eliminate the corporate income tax but not by substituting for it another tax that in practice might well be more harmful to economic efficiency, growth, and competitiveness.

Seminar from page 1

Rejuvenating service sector strength was the theme of the third panel. Emil M. Sunley of Deloitte & Touche moderated and introduced Thomas S. Neubig of Price Waterhouse, Henry Ruempler of the American Bankers Association, and Jane G. Gravelle of the Congressional Research Service.

Proceedings of the seminar will be available soon. Please contact the Foundation if you are interested.



Economist Leif H. Olsen finds the literature on the capital gains tax excessively absorbed with one question: Will a higher or lower rate produce more revenue? The more important issue to Olsen is its effect on capital formation and growth.



Congressman Richard T. Schulze holds up a Uniform Business Tax form which would replace the current, much more complex corporate tax return should his idea of a uniform business tax be proposed and enacted. Professor William Dunkelberg of Temple University looks on.



Catherine Porter, partner in the law firm of Miller & Chevalier, presided over a lively exchange on the wisdom of the subpart F rules.

FOUNDATION MESSAGE**U.S. High-tech Competitiveness and The R&D Tax Credit**

The last half of the 1980s was a great disappointment to Americans who see research and development (R&D) as vital to the nation's economy. Real growth in R&D expenditures only averaged 1.3 percent from 1985 to 1988, and suffered a 0.9 percent decrease in real growth during 1989, the first such decline in 14 years. This stagnant period contrasts sharply with the first half of the decade when R&D expenditures increased an average of 8.2 percent in constant dollars. The U.S. currently spends substantially less than either West Germany or Japan on non-defense R&D.

What role has tax policy played in this nosedive? What provisions of our tax code provide corporations with positive incentives to invest in research and development? Which provisions of the code inhibit R&D expenditures? Everyone here in Washington seems to agree on the benefits to our economy of more R&D. But despite this unanimity, the U.S. R&D tax credit has been since its inception in 1981 a jumble of short-term extensions and technical changes to its calculation that has not provided substantial incentive for U.S. firms to increase R&D expenditures.

A parallel and possibly related trend is the decline the U.S. is experiencing in its share of global sales of technology-intensive products. Tax Foundation senior research fellow B. Anthony Billings will soon publish a study on R&D intensity that examines its sensitivity to the R&D tax credit, changes in the corporate statutory tax rate, and changes in the corporate tax base.

On the political front, the R&D tax credit is in limbo with the rest of the "extenders"—tax provisions that must be reauthorized, or extended, every year. In judging which provisions should be subject to this reauthorization procedure, the R&D tax credit seems ill-suited. Since R&D projects that qualify for the credit are planned over a period of several years, the stimulus the credit provides is lessened by the uncertainty of its application in future years. A permanent credit, or at least a multi-year extension, would be a small but worthwhile step towards a more stable and reliable tax code, and possibly a boost to U.S. competitiveness.



Dan Witt
Executive Director

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Tax Freedom Day Analysis Brings Media to Foundation's Door

The publication of Tax Foundation's Tax Freedom Day Special Report last month brought more attention to the Foundation's public information program than any previous year's announcement of Tax Freedom Day.



The Foundation's executive director Dan Witt talks about the growing tax burden across the nation on the Radio America network.

Most of the new demand for Tax Foundation information came from the states, as the second year of the Foundation's calculation of a state-by-state Tax Freedom Day spurred interest in how each state's tax burden compared with those of neighboring states.

From April 24, the date of the nation's earliest Tax Freedom Day in Mississippi, until May 26 when the taxpayers of New York and the District of Columbia had finally earned enough to pay for govern-

ment, the Foundation's staff did radio interviews in over 30 states.

An important benefit of this attention is the media's greater reliance on the Foundation for economic analysis on other issues. Paul Merski, the Foundation's director of fiscal affairs, spoke on Maryland's fiscal situation at a conference entitled *Maryland Tax Policy: Who Pays and Who Benefits*. He was joined on the panel by noted federal budget authority Allen Schick, Director of the University of Maryland's Bureau of Government Research. Also speaking were Marcia Howard of the National Association of State Budget Officers, Hal Hovey, State Policy Research, and Steven Gold of the Center for the Study of the States. ■

Foundation Releases 1990 Annual Report

The Tax Foundation's annual report, just released, explains the mission of the Foundation and gives highlights of its accomplishments during 1990. Research, membership activities, publications, and media coverage are presented, along with messages from the Foundation's co-chairmen, James C. Miller III and James Q. Riordan, and its executive director, Dan Witt.



Paul Merski is interviewed by the CNN television network after a record-setting sale of Treasury bonds.

Tax Features

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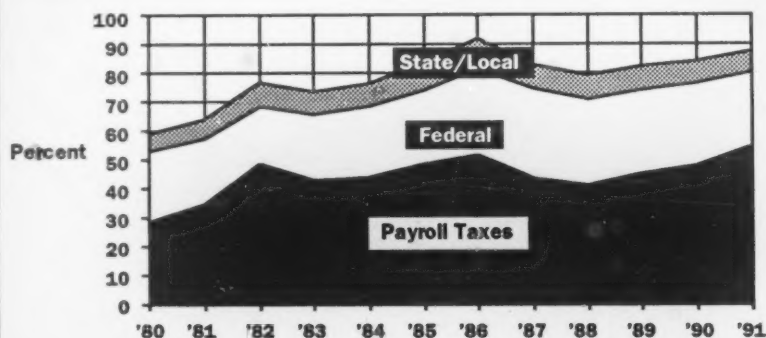
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Tax Features

New Study Shows Corporate Taxes Rising Despite Falling Profits

Despite recent declines in corporate profitability, the combined federal, state and local tax burden on American corporations rose steadily

Corporate Income and Payroll Taxes Relative to Corporate Profits 1980-1991



Source: Tax Foundation

State and local corporate income taxes have been increasing rapidly, and corporate payroll taxes are now the largest part of the business tax burden. Over the past decade, the combination of these increases with federal income taxes have caused a sharp rise in the overall corporate tax burden.

from 1980 to 1991, according to a new study by the Tax Foundation. Entitled *Corporate Tax Burden Rises As Profits Fall*, the study asserts that particularly rapid increases which have occurred in payroll taxes and state/local income taxes belie the notion that corporations do not shoulder their "fair share" of the tax load.

A good barometer of the corporate tax burden is a comparison of corporate taxes with corporate profits (see chart above). In 1980, corporate profits made up 10.8 percent of national income but had dived to 6.3 percent by 1990. Total corporate taxes did not experience a comparable decline, so that relative to profits, taxes increased 28.1 percentage points from 58.9 percent in 1980 to an estimated 87.0 percent in 1991. Throughout the 1970s, this rate averaged only 60 percent.

See Corporate Tax Burden on page 2

FRONT BURNER

Progress on Complicated Art of Tax Simplification



Tax simplification can be a complicated process, but it doesn't have to be. **Senator Lloyd Bentsen** contentious. A pair of identical bills—S.1394 and H.R. 2777—show how, working together, we can make progress toward streamlining America's tax laws.

Last month, I joined with House Ways and Means Committee Chairman Dan Rostenkowski, Senator Bob Packwood, the ranking Republican on the Senate Finance Committee, and Congressman Bill Archer, the ranking Republican on Ways and Means, in introducing these identical tax simplification bills.

The tax simplification proposals were developed in consultation with the Democratic and Republican staffs of the Finance Committee and the Ways and Means Committee, and the staffs of the Joint Committee on Taxation, the Treasury Department and the Internal Revenue Service. The staffs were directed to draft tax simplification proposals that, first, did not represent a change in tax policy, and, second, were either revenue neutral or had only a minimal revenue impact.

The tax simplification bill is not intended to be a completed project. It does not represent the final word on how the tax code can and should be simplified. Rather, the legislation is intended to start a dialogue on tax simplification proposals, to put some legislative language on the table. That way Americans will be able to take a closer look at the details of these proposals and obtain a better idea about how

See Bentsen on page 2

Senator Lloyd Bentsen, Democrat from Texas, is Chairman of the Senate Finance Committee.

The opinions expressed in the Front Burner are not necessarily those of the Tax Foundation. Editorial replies are encouraged.



Tax Foundation

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Bentsen from page 1

they would work. The resulting comments and suggestions from taxpayers and tax practitioners will help us further refine these proposals when necessary.

As Chairman of the Senate Finance Committee, I will also be scheduling

"The bill provides for a simplified form for individual tax returns. It would also simplify the reporting requirements for partnerships."

hearings on the legislation and tax simplification proposals more generally. I very much hope that the introduction of this bill will stimulate serious thinking and comment on how we can make our tax laws more simple.

Because of budgetary considerations, this bill represents a limited effort to simplify the tax rules. It is extremely difficult and perhaps impossible to enact major structural simplifications to the tax system without encountering serious revenue problems. We are severely constrained in this effort by the pay-as-you-go rules, and I will not move this bill or any part of the bill through the Finance Committee unless it pays for itself.

Even within the constraints the staffs operated under, our legislation includes a number of significant provisions. The bill provides for a simplified form for individual tax returns. It would also simplify the reporting requirements for partnerships. And it would significantly simplify the look-back method for calculating income from long-term contracts. These and other areas in the tax code have tied taxpayers and practitioners in knots and are ripe for simplification. In addition, the bill would enable the Internal Revenue Service to accept tax payments by credit card and thus simplify the payment of taxes once the tax forms have been filled out.

Two important areas in which we were unable to include proposals at this point were payroll tax deposit reform and simplification of the earned income

tax credit. Simplification is seriously needed in both areas —no doubt about it. While we were unable to reach agreement on the details of proposals in these areas to include in this bill, we will want to take a further look at these and other proposals as the tax simplification bill advances through the legislative process.

This bill represents one of a series of initiatives to simplify the tax laws. In the area of pension law, Senator David Pryor, Chairman of the Finance Subcommittee on Private Retirement Plans, and I introduced the Employee Benefits Simplification and Expansion Act of 1991 to encourage pension plans for more American workers. By streamlining the cumbersome pension laws, that legislation would encourage more employers to establish pension plan coverage for their employees.

The tax simplification legislation now on the table is an important first step. As we move forward, I'll be interested in hearing what American taxpayers and

"Two important areas in which we were unable to include proposals at this point were payroll tax deposit reform and simplification of the earned income tax credit."

Simplification is seriously needed in both areas —no doubt about it. . . . We will want to take a further look at these and other proposals as the tax simplification bill advances through the legislative process."

the people who must deal with the tax laws think about how these proposals would work.

Everyone agrees that our tax system is too complicated. Getting everyone to agree on how to simplify matters can be complicated too, but the consensus we've attained so far shows the potential for real progress. ■

Corporate Tax Burden from page 1

The 1991 overall corporate tax burden, representing a whopping 87 percent of corporate profits, is huge by historic standards. Federal deficit pressure and the sharp growth trend in state/local and payroll taxes can easily push this burden even higher.

"The decade began on a favorable note for corporate America when Congress enacted the Economic Recovery Tax Act of 1981 (ERTA)," according to the study. "If this sizeable tax cut had been allowed to take effect fully over the next several years, it would have substantially reduced overall corporate income tax liabilities. Instead, subsequent tax bills negated the effects of ERTA, and government's drive for more revenue became the major motivation behind most of the far-reaching tax legislation of the decade, with hardly a consideration of sound tax policy."

The cumulative effect of all this legislation was a substantial shift of income taxes from individuals to corporations. "In 1991 alone ... individual income tax receipts will be \$291 billion lower than they would have been had the tax code remained unchanged throughout the decade. Corporate income taxes, on the other hand, will be \$48 billion higher."

The claim is often made that corporations do not carry their fair share of the tax load, and the statistics accompanying these charges usually show corporate income taxes as a percentage of GNP or federal tax receipts. But when looking at corporate taxes, federal corporate income taxes are only part of the picture.

They have risen 24 percent since 1980, but state and local corporate income tax revenues have increased 39 percent in that time. The largest portion of the business tax burden, however, has become the corporate share of payroll taxes, far outstripping corporate income taxes and currently costing an estimated \$153 billion. ■

Mark Your Calendars**November 20, 1991**

for the

**Tax Foundation's
54th Annual Dinner &
43rd National Conference
at the Waldorf-Astoria
in
New York City**

Luxury Tax Misses the Boat As Tax Burden Shifts From Wealthy to Middle Class and Revenue Estimates in Doubt

by Monica Fekete

Last fall, Congress and the President attempted to make the nation's second largest tax increase more palatable to the middle class by adding "progressive" excises, i.e., "luxury taxes" on items which only wealthy people buy. Yachts, furs, automobiles, jewelry, and personal aircraft above a certain price have been subject to a 10 percent excise since January 1, 1991 (see table 1).

For two important reasons this new tax is shaping up to be a failure. First, passing such a narrowly based excise is simply bad tax policy, and second, the impact of the tax has been felt not just by wealthy consumers but by middle class employees in the targeted industries.

Inequitable Tax Policy

An equitable tax should be broadly based, allowing a lower rate and more equivalent effect across industries and income groups. Yet lawmakers negotiating 1990's budget package limited the luxury tax to five industries, and further narrowed their sights to those items with high retail prices.

Lower sales and a host of other negative results can flow from this. But when taxwriters are looking for a quick revenue fix or, as in this case, a highly visible tax on an unpopular group, they often turn to these ineffective "rifle shot" taxes on specific industries or income groups.

Luxury Taxes and the Middle Class

The luxury taxes were enacted un-

der the assumption that they would be paid by the wealthy, but based on preliminary data, sales of luxury items are down, leading to lost jobs in the targeted industries. The revenues collected in the name of the luxury taxes are certainly

tential tax revenues from payroll and personal income tax sources are considered, a net government revenue loss is quite likely.

Other possible implications of the tax include:

Table 1
Luxury Tax Schedule

Item	When Applied	Doesn't Apply When	Tax Avoidance Examples
Jewelry	New or re-worked jewelry over a final value of \$10,000, including watches	Repairs and minor modifications	Reworking described as repairs and minor modifications
Furs	New garments made up of at least 25% fur, over a retail price of \$10,000	Fur comprises less than 25% of the garment	Bring to the U.S. from Canada, avoiding the taxes since trade between the two countries is tax-free under the new trade agreement
Automobiles	New passenger vehicles over \$30,000, counting modifications made within 6 mos. of purchase	Used in business	Wait 6 mos. before making modifications
Boats and Yachts	New boats and yachts over a retail price of \$100,000	Used in business unless for entertainment	Purchase overseas and ship in the Bahamas or purchase used
Personal Aircraft	New aircraft over a retail price of \$250,000	Used more than 80% of the time for business	Purchase used

Source: Tax Foundation

paid by the wealthy, but middle class workers who lose jobs in the targeted industries can take little solace in that.

Revenue Gainer or Loser?

The Joint Committee on Taxation (JCT) estimated last fall that luxury taxes would bring in \$25 million in 1991 and \$1.5 billion over five years (see table 2). According to the Internal Revenue Service (IRS), the federal government had already collected \$33 million in first-quarter taxes as of May 31. The actual tax revenue has exceeded estimates in four of the five industries, with revenue six times higher in the automobile industry and eight times higher for jewelry.

But both the original JCT estimate and the annualized IRS collections ignore the impact of the tax on employees in these industries. When lower po-

• Revenue lost from other sales taxes;

• The high cost of compliance with the luxury tax, both for business and the IRS (the IRS lists on its Form 720 the average amount of time suggested for record-keeping and form preparation for the luxury tax: 2 and 1/2 days per quarter for the average corporation); and

• less corporate income tax revenue due to reduced sales.

Conclusion

An efficient and equitable tax should be broadly based — not limited to a specific industry or income group. Unfortunately, the luxury tax does not meet these fundamental criteria for sound tax policy since it targets only five industries and upper income groups.

Although revenue collections have been many times higher than JCT estimates, the tax may in fact lose billions when the full impact on the economy is examined, taking into account compliance costs, lost sales and jobs, and lower income and payroll tax receipts. ■

Table 2
Estimated Revenues v. Actual Revenues
(\$Thousands)

Item	Original 1991 Estimate ^a	1991 Revenue Projection from Actual Collections ^b	1st Quarter Actual Collections ^c
Jewelry	\$1,000	\$8,848	\$2,212
Furs	*	1,028	257
Automobiles	20,000	117,032	29,258
Boats & Yachts	3,000	3,600	900
Planes	1,000	480	120
Total	\$25,000	\$130,988	\$32,747

^a Joint Committee on Taxation.

^b Annualized IRS collections.

^c IRS collections data through 5/31/91.

* not available

Top Corporate Executives Bring Concerns About U.S. Competitiveness Before Ways and Means Committee

Lowest Corporate Tax Rate Is Best Government Policy



Allen F. Jacobson

I represent the Emergency Committee for American Trade—better known as ECAT—whose members are the heads of 62 U.S.-based international business enterprises. The annual worldwide sales of ECAT companies are over one trillion dollars, and our companies employ more than five million people.

I also represent 3M—a multinational, multiproduct, multi-technology, multimarket company—which has facilities in over 53 countries. 3M sales in 1990 were over \$13.02 billion. Almost 49 percent of those sales were derived from our international operations compared to 37 percent in 1985.

A major accomplishment of our government was the enactment of the Tax Reform Act of 1986 which lowered the corporate tax rate. I can tell you that the lowering of the corporate tax rate has enhanced 3M's competitiveness in the United States and in markets outside our country.

When 3M looks at an investment in equipment, in efficiency or in expansion, it looks at the stream of earnings that the investment will produce. The lower the tax rate, the better the stream of earnings and the more that we can invest and the more we can be competitive. That low tax rate

I can tell you that the lowering of the corporate tax rate has enhanced 3M's competitiveness in the United States and in markets outside our country.

encourages better business decisions and better investment in competitiveness for 3M than tax incentives such as investment tax credits.

In the near future, ECAT will complete and release a study which uses U.S. government data on exports and repatriated earnings of multinational corporations during the 1980s. This study reveals that these U.S.-based multinational corporations made a net positive contribution to the U.S. balance of payments that averaged over \$80 billion annually during the period 1980-88.

Something obviously has been going right. What should be done in the future?

I have mentioned the necessity of keeping the corporate tax rate as low as possible. I also think that there is an argument

for keeping changes in the tax code at a minimum. The tax system needs a settling down—an extended period of time in which there is no abrupt change in revenue policy. This will serve to improve business planning and performance.

As it looks at the competitive position of the United States in the world economy, the Congress also should be wary of imposing substantial new social costs on business. In 3M's U.S.

As it looks at the competitive position of the United States in the world economy, the Congress also should be wary of imposing substantial new social costs on business.

operations, such costs have been increasing substantially over the years. Right now, our benefit costs are equal to 36.3 percent of our payroll. We believe in giving our employees good benefits, but we ask that you not transfer to us the costs of benefits of other employers.

Many of our ECAT members are concerned about changes that have taken place in recent years to the foreign tax credit and deferral. These changes have been enacted because of a need to increase revenue, but, for many of our members, the amounts of increased tax are not inconsequential and have a negative impact on their competitiveness.

I think that the competitiveness of the U.S. should be foremost in our minds as we consider tax, trade and foreign investment policies and regulations.

We should be careful not to adopt counterproductive policies in our zeal to address balance of trade problems and the national deficit. In the future, as we review the range of challenges faced by the United States as it participates in an enlarged world economy, it may be necessary to remind ourselves that companies cannot be competitive unless they also are profitable. ■

Improved Education Needed to Compete

Honeywell is a stronger international competitor today as a result of fundamental restructuring of the tax code that began in 1986. But we are concerned about the strength of American industry in general.

Global competitors like Honeywell depend on at least five leverage points: cost of capital, productivity, scale of production, global distribution and technology. Our ability to com-



James J. Renier

Allen F. Jacobson is Chairman and CEO of 3M Corporation.

James J. Renier is chairman and CEO of Honeywell Inc.

pete in terms of capital and production relies heavily on our ability to take a long-term view of the development, protection and utilization of technology.

America is still a world leader in computer-aided engineering, artificial intelligence, software engineering, and computer-integrated manufacturing. Utilized effectively, these and other technologies can produce competitive gains. That requires skilled people who can work in this high-tech environment.

Today's jobs require a median of 12.5 years of education. But jobs created during this decade will require 13.5 years, and by the year 2000 a third of all jobs will require a college degree. The ad hoc solutions we have developed in response to the deficiency in our workforce's education is totally inadequate, and the data—with few exceptions—bear this out. What concerns me is that we seem to be reacting to changes in technological competition in a similar ad hoc fashion.

Long-term, risky and expensive investments in technology development are made on the assumption that, if successful, investors will enjoy a long-term return on the investment, and build on its initial success. But sizeable investments can be jeopardized by patent infringements. They have cost our company many millions of dollars, so we place a premium on establishing effective, enforceable intellectual property rules through the Uruguay Round and other trade negotiations. It is important, however, that the negotiations not result in weaker protection than now provided by U.S. trade law.

Development of technology cannot be turned off and on like a faucet. It requires a long-term commitment. For example, Honeywell began R&D on the Ring Laser Gyro—a gyro for aircraft navigation that uses laser beams instead of moving parts—in 1962. It has since become the standard of the industry, worldwide, but it did not become profitable until 1985.

Like the utilization and protection of technology, advances in the state of the art will not happen automatically. Industry must see the potential gain in the enterprise, and must be confident that Congress understands and considers industry needs. ■

High-Tech Success Vital to U.S. Economy

I am very troubled about American competitiveness. One must be alarmed when:

- seven of the top ten recipients of U.S. patents are foreign companies;
- U.S. industry is weak or losing badly in one-third of the critical generic technologies that drive economic prosperity; and
- the U.S. world market share in data processing and office



James R. Houghton

James R. Houghton is Chairman of the Board and CEO of Corning Incorporated.

automation equipment—the very tools of the Information Age pioneered in the United States—has dropped from 51 percent to 32 percent since 1984.

But rather than focusing on the negative, I'd like to urge:

- a commitment to technology;
- a long-term business orientation; and
- a commitment to total quality.

As Corning learned with the success of fiber optics, we can't create good paying jobs for our workers unless we invent new products and new processes.

So what can government do? I commend a technology plan for governmental action developed by the Council on Competitiveness, whose recommendations include:

There are policy levers that can be used to reduce the cost of equity, thus encouraging firms to be more long-term oriented . . . [such as] reducing the federal budget deficit or by creating incentive for private savings.

- making research on generic industrial technologies a national R&D priority as stated in the President's proposal;
- creating an economic climate more conducive to manufacturing, innovation, and investment in technology by such measures as the permanent extension of the R&D tax credit;
- communicating the priority of technology and competitiveness to the American public as President Kennedy did after Sputnik; and
- developing policies and programs to ensure that we have a world-class technology infrastructure, including an improved educational system.

U.S. businesses need to be more long-term oriented. Unfortunately, the financial pressures on American business managers are for short-term results. I'm convinced that our short-term orientation is driven by our relatively high cost of capital, particularly the cost of equity.

The cost of capital is composed of two parts: the cost of debt and the cost of equity. Our cost of debt—interest rates—is similar to that of our principal technology competitors, Japan and Germany. But most economists agree that our cost of equity—the return our shareholders expect—is substantially higher. One study indicates that it is as much as 4 to 6 percentage points higher.

There are policy levers that can be used to reduce the cost of equity, thus encouraging firms to be more long-term oriented. One is increasing the pool of savings which finances most equity investments. This could be achieved by reducing the federal budget deficit or by creating incentive for private savings. Another possible solution is encouraging equity investors to be more long-term oriented by allowing a lower tax on capital gains after an extended holding period.

I realize that technology and long-term orientation alone won't make America competitive, but progress in these areas is a vital component of a strategy for American competitiveness. ■

How Governments Raise and Spend Each Dollar of Public Funds

How Governments Collect . . .

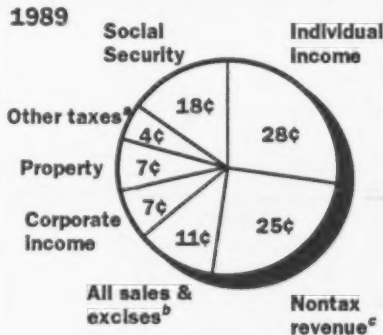
Just over 28 cents of every dollar raised by federal, state, and local governments came from individual income taxes during fiscal year 1989, according to Tax Foundation analysis of the latest reported data. Over the course of several years, the individual income tax had been slowly losing its dominance as governments' principal revenue source. But this trend was reversed in 1989, as governments tapped that source for 28.3 percent of their revenue, up from 27.6 percent in 1988. Individual income taxes accounted for 40 percent of all federal revenues, but for states it was only 15 percent, and it constituted a mere 1.7 percent share for local governments. In the aggregate, the individual income tax raked in \$543 billion of the total \$1.917 trillion in revenue received by all levels of government combined.

Other High Revenue Sources

The federal Social Security program was FY89's second largest government revenue source, netting 18 cents of each tax dollar collected, or a total of \$339.5 billion. These payroll taxes, which are collected by neither state nor local gov-

ernments — only by the federal government, have nevertheless been the fastest growing of all taxes over the last three

How Do Governments Raise A Dollar of Public Funds?



^a Includes death and gift taxes, motor vehicle and operators' licenses, unemployment contributions, and miscellaneous taxes.

^b Includes general sales taxes and selective sales and excises.

^c Includes current charges employee retirement, utilities and liquor stores, interest earnings, special assessments, sale of property, and other miscellaneous and nontax revenues.

Source: Tax Foundation computations; data from U.S. Department of Commerce, Bureau of the Census.

decades. In 1989 Social Security tax collections were 30 times as large as in 1960, rising from 7 cents per dollar of total government revenue to 17.7 cents.

Sales Tax Contributions Falling

Despite rising from \$16.9 billion in 1960 to \$105.5 billion in 1989, government collection of selected sales and excise taxes has declined in relation to the growth of other taxes. Gasoline, tobacco, and alcohol excises are the principal taxes in this category, and as a portion of each tax dollar collected, they have declined from 12.5 to 5.5 cents over the thirty-year period.

Government Deficits

Despite government collections \$141 billion higher in 1989 than in 1988, total government deficits declined only \$30.8 billion to \$113.2 billion, thanks to a rise in total spending of \$110 billion. The federal government's deficit alone was \$177 billion, or 14 percent of federal outlays. State and local governments bailed out the federal government to some extent by producing surpluses of \$62 billion and \$1.5 billion respectively. (See table 1 for details.)

See Taxing and Spending on page 7

Table 1

How Federal, State, and Local Governments Raise Each Dollar of Public Funds

Selected Fiscal Years 1960-1989

(Cents Per Dollar of Total Revenue)

Source	1960	1970	1980	1988	1989
Total Tax Revenues	82.7	82.4	78.2	74.9	75.5
Individual Income	28.2	30.3	30.7	27.6	28.3
Social Security (OASDHI)	7.0	11.5	15.0	17.5	17.7
Property	10.7	10.2	7.3	7.4	7.4
Selective sales & excises	12.5	9.8	6.5	5.8	5.5
Corporate Income	14.8	11.0	8.4	6.6	6.7
General sales	3.5	4.8	5.5	5.9	5.9
Other taxes ^a	6.0	4.8	4.8	4.0	3.9
Nontax Revenues	17.3	17.6	21.8	25.1	24.5
Current charges	8.1	7.9	8.6	9.8	9.4
Miscellaneous general ^b	3.3	4.0	6.7	7.1	7.0
Employee retirement	1.9	2.5	3.1	4.6	4.5
Utilities and liquor stores	3.2	2.6	2.7	3.0	2.9
Other Nontaxes	0.8	0.6	0.7	0.6	0.7
Exhibit (\$billions)					
Total revenues	\$153.1	\$333.8	\$932.2	\$1,776.0	\$1,917.5
Surplus or deficit (-)	\$1.8	\$0.8	-\$26.5	-\$144.1	-\$113.2

^a Includes death and gift taxes, motor vehicle and operators' licenses, unemployment contributions, and miscellaneous taxes.

^b Includes interest earnings, special assessments, sale of property, and other general revenue.

Source: Tax Foundation computations based on data from U.S. Department of Commerce, Bureau of the Census.

Table 2

How Federal, State and Local Governments Spend Each Dollar of Public Funds

Selected Fiscal Years 1960-1989

(Cents Per Dollar of Total Spending)

Source	1960	1970	1980	1988	1989
Major social welfare programs, total	20.1	25.5	33.2	31.7	30.1
Social Security (OASDHI)	7.1	10.8	15.6	15.6	15.8
Social services and income maintenance ^a	11.0	12.3	14.5	12.9	11.1
Government employee retirement	2.0	2.4	3.1	3.2	3.2
National defense and international relations	32.3	25.3	15.6	17.2	17.1
Education	12.8	16.7	15.0	13.4	13.8
Interest on general debt	6.2	5.5	7.9	10.5	10.9
Environment and housing	5.4	4.4	5.0	6.7	5.3
Utilities and liquor stores	3.4	2.8	3.8	3.6	3.6
Transportation	7.6	6.2	4.5	3.7	3.7
Public safety	1.8	2.0	2.3	3.5	3.6
Government administration	1.8	1.9	2.2	2.5	2.6
Postal service (Federal)	2.5	2.3	1.9	1.8	1.8
Sanitation	1.1	1.0	1.4	1.2	1.3
All other	5.0	6.4	7.2	4.2	6.2
Exhibit (\$billions)					
Total spending	\$151.3	\$330.0	\$958.7	\$1,920.1	\$2,030.7

^a Includes public welfare, hospitals, health, social insurance administration, veterans benefits, and other insurance trust expenditures.

Source: Tax Foundation computations based on data from U.S. Department of Commerce, Bureau of the Census.

Taxing and Spending from page 6

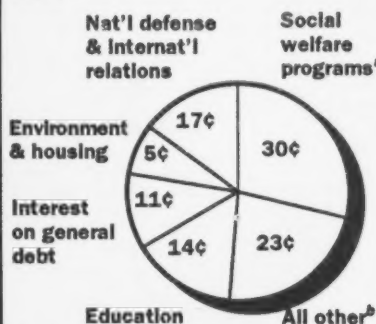
... And How They Spend

Social Welfare Programs Continue to Dominate

Governments spent \$612 billion on social welfare programs in 1989 (latest reported data), over 30 cents of each dollar governments spent. Federal Social Security accounted for half of social welfare expenses, or 15.8 cents of every government dollar. Also included in this category are such social services and income maintenance programs as public welfare, health and hospitals, veterans

How Do Governments Spend A Dollar of Public Funds?

1989



* Includes public welfare, hospitals, health, social insurance administration, veterans benefits, and other insurance trust expenditures.

* Transportation, utilities and liquor stores, public safety, government administration, postal service, sanitation, and all other.

Source: Tax Foundation computations; data from U.S. Department of Commerce, Bureau of the Census.

benefits, and unemployment insurance. These accounted for 11 cents of each dollar of government spending. Another substantial component of social welfare programs is government employee retirement, which took 3 cents of every dollar in 1989 (see table 2 on page 6 for details). Although spending on social welfare expenditures increased \$44.3 billion from 1988 to 1989, this category actually received a smaller piece of the ever-larger spending pie, 30.1 cents per dollar instead of 31.6.

The same is true for national defense and international relations, which despite a spending increase of \$16.3 billion from 1988 to 1989, actually constituted only 17.1 cents per dollar spent in 1989 instead of the 17.2 cents it represented in

FOUNDATION MESSAGE

Tax Action Moves From Nation's Capital to State Capitals

When the federal government's taxwriting machine heats up, Washington, D.C. is the best seat in the house—for lobbyists, for policy analysts, for any citizens concerned about government taxing and spending. But in 1991 Washington insiders are looking wistfully past the beltway—it's the year of the states. California and New York have already passed major tax bills, and together with Pennsylvania, Connecticut and Texas, where action is still pending in legislative sessions, the combined tax increases at the state level this year will exceed the gigantic federal tax increase passed in 1990.

What is the cause of this flurry of taxwriting in state capitals? 'Recession' is the most commonly heard answer. And it's true that the recession has made a mockery of state revenue estimates. It has devastated sales tax revenues and, with employment flagging, states have suffered the double-whammy of lower payroll tax revenue and higher unemployment compensation. It is definitely the proximate cause of the huge state budget deficits we are seeing.

On the other hand, we have just finished a decade of steady economic growth with GNP rising an average of 7.4 percent. Did state coffers grow to the point where they could withstand a recession? Just the opposite. State spending increased an average of 8.5 percent per year, and state/local debt grew an average of 8.2 percent annually during the decade. And this pattern of accelerating state/local taxes is not a phenomenon of the 1980s; since 1950, state/local taxes have increased from 6.10 percent of GNP to 10.75 percent.

The net result is that states in bad fiscal shape are raising taxes. Will they do so in a way that minimizes negative impact on the economy? Or will they go on a desperate revenue-raising spree with no thought to sound tax policy?

Unwilling to pass judgment long-distance on state fiscal problems, the Tax Foundation is holding a series of programs in the states to answer these questions. The general theme will be "Tax Policy and Economic Growth," and each program will feature state-level government officials, as well as authorities from local universities and major corporations in the area.

The next issue of *Tax Features* will report on our program in Chicago July 24th and preview our upcoming seminar in Pittsburgh. State tax issues are even harder to track than federal developments, so stay tuned.



Dan Witt
Executive Director

1988. Over the last thirty years, social welfare expenditures have appropriated more and more government spending, mostly at the expense of national defense. A comparison of 1960 spending figures with 1989's shows a virtual flip-flop of the two categories, with social welfare spending increasing from 20.1 to 30.1 cents per dollar while national defense and international relations dropped from 32.3 to 17.1 cents. As health and retirement costs soar and the government announces new military cutbacks, this trend seems likely to continue.

The fastest growing of all government costs has been debt-related outlays. Interest payments on government debt were 6.2 cents in 1960, 7.9 cents in 1980, and 10.9 cents in 1989 when the nation spent nearly \$221 billion dollars on maintenance of prior debt. Most of this interest cost was due to the federal debt, which reached \$2.88 trillion in 1989. State and local governments have much less debt (\$798 billion aggregate) due to constitutional and legislative requirements mandating balanced budgets. ■

Foundation's Policy Council Holds Tax Policy Colloquium in NYC

The Foundation's Policy Council and distinguished guests convened June 19 in the offices of the Metropolitan Life Insurance Company in New York City. Hosted by Stuart Nagler, senior executive vice president at Met Life, the luncheon was an off-the-record roundtable on current issues in tax policy. Corporate executives and university scholars discussed such issues as tax "fairness," and the revenue estimating process.



Robert Bartley, Editor, Wall Street Journal



Senator Harry F. Byrd, Jr., recipient of the Foundation's Distinguished Service Award.



James Q. Riordan, co-chairman of the Tax Foundation.

University of Texas Law School Student Finishes Internship at Foundation

Monica Fekete is finishing her term as the Foundation's summer intern and returning to Austin, Texas to continue her legal

education. The Foundation offers internships every summer as an extension of its College Classroom Project. Ms. Fekete reported on congressional testimony and conducted studies of government taxing and spending, the current status of the government's indebtedness, and the newly passed luxury tax (see page 3). ■



◀ **Monica Fekete pictured with Gregory Leong (l), Director of Special Studies, and Paul Merski, Director of Fiscal Affairs.**

Tax Features

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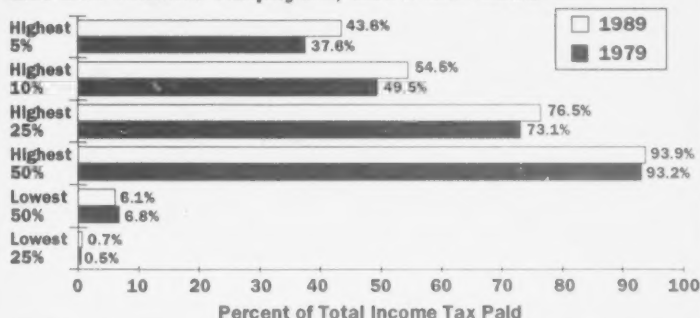
Tax Features

Top Tenth of Taxpayers Pays Over Half of Individual Income Taxes

Top Half Pays Over 90 Percent

The top-earning ten percent of U.S. taxpayers paid nearly 55 percent of the federal individual income tax bill in 1989, according to Tax

Percent of Federal Individual Income Taxes Paid by High and Low Income Taxpayers, 1979 and 1989



Source: Tax Foundation computations based on Statistics of Income, Internal Revenue Service, U.S. Department of the Treasury.



Tax Foundation

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Foundation analysis of the recently released 1989 IRS tax return data. Despite all the major tax legislation witnessed over the decade of the 1980s, the fraction of income taxes collected from this top ten percent varied only slightly from year to year between 1979 and 1989 but inched steadily up during the decade.

After paying 49.5 percent of all federal individual income taxes collected in 1979, these taxpayers, who now number 11.2 million, put a little more into the till most years until in 1989 they paid 54.5 percent. While their adjusted gross income (AGI) rose 89 percent from 1979 to 1989, their average tax payment rose even more — 94 percent — and averaged \$22,225 in 1989. Their AGI ranged down to \$61,780, not exactly "fat cat" status. It still takes millions of middle and upper-middle income taxpayers to pay the bulk of the total income tax bill.

All segments of the top earning half paid a

See Tax Burdens on page 5

FRONT BURNER

Encourage Savings Without Penalties



Senator Bob Packwood

Since I've been in Congress, we have tried many tax incentives to encourage Americans to save more. One of the more successful ideas is the tax-deferred savings plan, exemplified by 401(k) and 403(b) savings plans and Individual Retirement Accounts (IRAs). There is almost \$600 billion now in those savings plans.

But many Americans, and especially younger workers, are reluctant to use these savings plans. For example, less than seven percent of younger workers (under age 35) contribute to an IRA. Why? Because they do not want to be hit with a 10-percent "early withdrawal penalty" if they withdraw their money before retirement, generally, age 59 1/2.

Most younger Americans have a difficult time making ends meet. They are just starting out in their careers. They are in their early years of parenting. Their incomes are low and their expenses are high. But, they need to set aside funds for unforeseen events, such as loss of employment or high medical bills. They want to save for a first home. As their children grow up, they must save for their children's college education.

Yet, if Americans put money in a tax-deferred savings plan, the tax code punishes them for withdrawing money for these purposes by imposing a 10-percent penalty.

This is not right. We should encourage Americans to save, not penalize them. It's become more and more difficult for them to save. For example, home ownership among

See Packwood on page 2

Senator Bob Packwood, Republican from Oregon, is the Ranking Minority Member of the Senate Finance Committee.

The opinions expressed in the Front Burner are not necessarily those of the Tax Foundation. Editorial replies are encouraged.

Packwood from page 1

younger families has declined 15 percent over the last eight years. We cannot afford to let this trend continue.

In my home state, the timber indus-

"Less than seven percent of younger workers (under age 35) contribute to an IRA. Why? Because they do not want to be hit with a 10-percent 'early withdrawal penalty' if they withdraw their money before retirement."

try has fallen on hard times. The number of unemployed timber workers will only continue to grow. Those who were fortunate enough to put aside funds in an IRA or similar account need every penny of those funds to put food on their family's table. It's ridiculous to make them pay 10-percent of their savings to the federal government.

Health care expenses in this country have continued their double-digit increase. Employers are attempting to deal

"Home ownership among younger families has declined 15 percent over the last eight years. We cannot afford to let this trend continue."

with these rising costs by increasing the employee's deductibles and co-insurance. For many employees, payment of these out-of-pocket costs for a prolonged illness or numerous medical problems can be financially devastating. Families should be able to use their savings to meet these needs without penalty.

Education expenses at colleges and universities are another significant out-of-pocket cost for families. The annual cost of a college education is now be-

tween \$6,000 and \$15,000. A recent survey found that only half of the parents who hope to send their children to college have saved even a small portion of the amount needed for tuition, room and board, and books. We must do more to encourage families to save.

IRAs are just one vehicle for savings. Others, such as 401(k) plans, have been growing in popularity during the 1980s and have proven to be an effective way

"Younger Americans . . . want to save for a first home. As their children grow up, they must save for their children's college education. . . Yet, if Americans put money in a tax-deferred savings plan, the tax code punishes them for withdrawing money for these purposes by imposing a 10 percent penalty. That is not right."

to save. 401(k) plans are now offered by over 50 percent of employers with more than 250 employees, and by more than 90 percent of large employers. The problem with IRAs and tax-deferred savings

"A recent survey found that only half of the parents who hope to send their children to college have saved even a small portion of the amount needed for tuition, room and board, and books. We must do more to encourage families to save."

plans such as 401(k) and 403(b) savings plans is that the incentive to save is limited to retirement. The savings put into these plans cannot be withdrawn for other purposes without the saver suffering a serious financial penalty.

The legislation I propose will allow Americans to use 401(k) and 403(b) savings plans and IRAs to save for the following purposes without incurring a 10-percent penalty:

1. Purchase of a first home by the taxpayer and the taxpayer's spouse, child or grandchild.

"In my home state, the . . . number of unemployed timber workers will only continue to grow. Those who were fortunate enough to put aside funds in an IRA or similar account need every penny of those funds to put food on their family's table. It's ridiculous to make them pay 10-percent of their savings to the federal government."

2. Periods of unemployment of the taxpayer lasting longer than six months.

3. Catastrophic medical expenses.

4. College education for the taxpayer and the taxpayer's spouse, child or grandchild.

Amounts withdrawn penalty-free because of unemployment could be repaid to the account within one year of returning to employment. Repaid amounts would be tax deductible.

The idea of allowing penalty-free withdrawals from retirement savings accounts for special needs is not a new one. My bill incorporates the best features of various proposals, and I strongly believe that enacting this legislation will encourage Americans to save more and strengthen the U.S. economy.

Mark Your Calendars

November 20, 1991

for the

**Tax Foundation's
54th Annual Dinner &
43rd National Conference
at the Waldorf-Astoria
in
New York City**

Foundation Promotes Sound Research and Development Tax Policy Before Ways and Means Committee

Dr. B. Anthony Billings, senior research fellow at the Tax Foundation and professor of tax accounting at Wayne State University, appeared before the Ways and Means Committee on July 17 to testify on U.S. international competitiveness. He emphasized the vital role that U.S. R&D tax policy could play in boosting U.S. competitiveness and compared U.S. R&D spending with that of selected major trading nations (see figure below).

Billings pointed out that the U.S. has been losing market share of technologically intensive products, an area which he asserts is particularly sensitive to our nation's R&D tax policy, which has "failed to offer the U.S. private sector adequate economic incentives to encourage R&D activities."

After a study of fourteen industrial groups in Japan and the U.S., Billings concluded that U.S. companies' R&D programs are just as efficient as their Japanese counterparts. He therefore cites U.S. R&D tax policy as responsible for our relatively poor performance in high-tech industries.

He offers three prescriptions:

Reallocate funds from government-sponsored R&D programs to a tax incentive. "Most technological breakthroughs result from private-sector projects rather than government-sponsored projects."



Dr. B. Anthony Billings, senior research fellow at the Tax Foundation, appears before the House Ways and Means Committee.

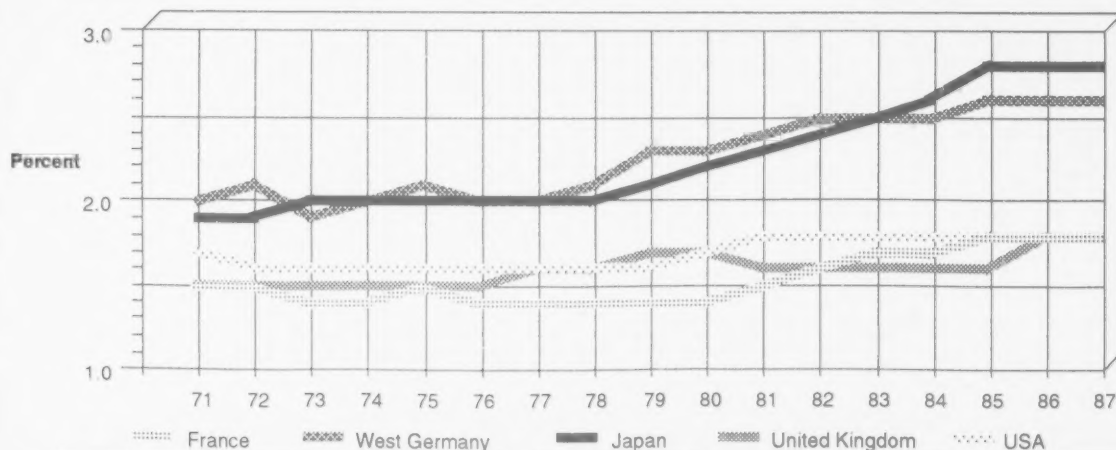
Revise the R&D tax credit provisions to allow for a credit based on total R&D. The current policy of allowing a tax credit only on incremental R&D spending "ignores the nature of R&D spending patterns. A more appropriate approach would be to base the credit on the total R&D outlay in the current period."

Combine R&D tax incentives with other measures. One practice of most of our major trading partners is to offer

export incentives through the classification of certain sales as foreign source income.

Professor Billings asserted that these changes could be paid for by reallocating funds that are currently devoted to government-sponsored R&D, and that the change "would foster greater efficiency in American industries without a revenue cost to the U.S. Treasury." ■

Estimated Non-Defense R&D Expenditures as a Percentage of Gross National Product



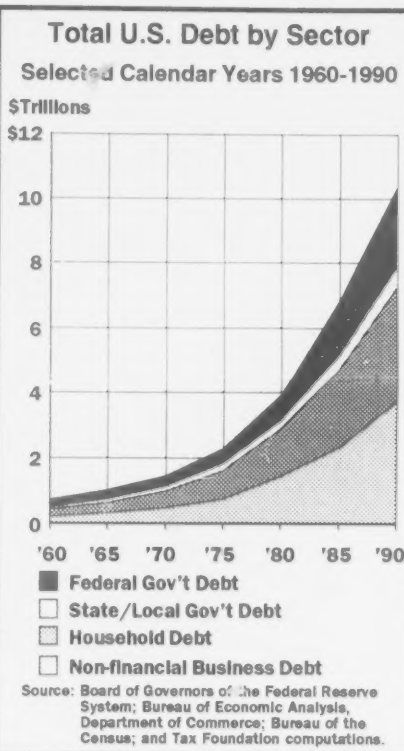
Source: National Science Foundation, *International Science and Technology Data Update: 1988* (NSF 89-307), Washington, D.C., 19889.

Study of U.S. Debt Shows Ten-Year Period of Tremendous Growth

As the nation struggles to work its way out of recession, Americans are feeling the pinch of the \$10.6 trillion total U.S. debt, according to a new Tax Foundation report entitled *A Nation in Debt* (6 pp., \$10). Fueled by record spending at all levels of government, highly leveraged financing by corporations, and record consumer credit card spending, the debt currently amounts to a \$42,277 IOU for every man, woman, and child in the United States.

In the 1980s, total U.S. debt nearly tripled, jumping from \$3.9 to \$10.6 trillion (see table and figure). Despite the doubling of household and non-financial business debt, their percentage shares of total debt have actually fallen slightly due to the even more rapid increase of the federal government's debt.

The federal government's spending spree during the 1980s tripled its debt from \$743 billion in 1980 to \$2.5 trillion in 1990, increasing the federal slice of the total debt from 19 to 24 percent. State and local government debt has grown less rapidly, but nevertheless, it has more than doubled during the decade.



Is U.S. Debt Really Too Large?

As gross national product (GNP) increases, so does an economy's ability to incur debt without seriously impeding economic growth, but the growth in total U.S. debt has steadily outpaced national output. The debt is currently almost double the nation's \$5.4 trillion GNP.

In 1990, the federal government made net interest payments of \$186.3 billion, or 15 cents of every dollar it spent. By comparison, it only spent 9 cents per dollar on interest in 1980. Unlike the federal government, state and local governments earned more interest than they paid out, generating \$41.6 billion in 1990 revenues.

The Federal Debt

Between 1980 and 1990, the federal government's debt almost doubled as a percentage of GNP, increasing from 27 to 45 percent. These figures would not be nearly as surprising if the 1980s had been a period of economic stagnation. On the contrary, GNP grew at the robust rate of 7.4 percent during the decade, but increasingly monumental federal deficits overwhelmed this growth. Starting the

See *U.S. Debt* on page 5

Total U.S. Credit Market Debt Outstanding by Sector

Per Capita and Percent of Gross National Product

Selected Calendar Years 1960-1991

(\$Billions except per capita)

	Total Debt Outstanding			Federal Government(a)			State/Local Governments			Households			Non-Financial Businesses		
	Total	Per Capita	Percent of GNP	Total	Per Capita	Percent of GNP	Total	Per Capita	Percent of GNP	Total	Per Capita	Percent of GNP	Total	Per Capita	Percent of GNP
1960	\$727.3	\$4,026	141.1%	\$236.3	\$1,308	45.9%	\$72.0	\$399	14.0%	\$218.2	\$1,208	42.3%	\$200.8	\$1,111	39.0%
1965	1,011.6	5,206	143.5	262.4	1,350	37.2	103.1	531	14.6	343.2	1,766	48.7	302.9	1,559	43.0
1970	1,424.4	6,947	140.3	300.8	1,467	29.8	150.3	733	14.8	471.8	2,301	46.5	501.5	2,448	49.4
1975	2,256.0	10,446	141.1	446.3	2,068	27.9	219.4	1,016	13.7	750.4	3,475	46.9	839.9	3,889	52.5
1980	3,897.7	17,116	142.7	742.8	3,262	27.2	286.6	1,259	10.5	1,430.2	6,281	52.3	1,438.1	6,315	52.6
1981	4,279.6	18,611	140.2	830.1	3,610	27.2	303.7	1,321	9.9	1,549.2	6,737	50.8	1,596.6	6,943	52.3
1982	4,667.6	20,104	147.4	991.4	4,270	31.3	331.4	1,427	10.5	1,626.3	7,005	51.4	1,718.5	7,402	54.3
1983	5,208.5	22,230	152.9	1,177.9	5,027	34.6	355.0	1,515	10.4	1,791.9	7,648	52.6	1,883.7	8,040	55.3
1984	5,959.4	25,215	158.0	1,376.8	5,825	36.5	383.0	1,621	10.2	2,018.8	8,542	53.5	2,180.8	9,227	57.8
1985	6,804.5	28,534	169.5	1,600.4	6,711	39.9	473.9	1,987	11.8	2,296.0	9,628	57.2	2,434.2	10,208	60.6
1986	7,646.3	31,772	180.7	1,815.4	7,543	42.9	510.1	2,120	12.1	2,596.1	10,788	61.4	2,724.8	11,322	64.4
1987	8,343.9	34,362	184.8	1,980.3	8,073	43.4	558.9	2,302	12.4	2,879.1	11,857	63.8	2,945.6	12,131	65.2
1988	9,096.0	37,119	186.6	2,117.8	8,642	43.5	604.5	2,467	12.4	3,191.5	13,024	65.5	3,182.2	12,968	65.3
1989	9,805.3	39,641	188.5	2,269.4	9,175	43.6	634.1	2,564	12.2	3,501.8	14,157	67.3	3,400.0	13,746	65.4
1990(b)	10,317.6	41,275	188.8	2,450.4	9,803	44.8	642.2	2,569	11.8	3,731.8	14,929	68.3	3,493.2	13,974	63.9
1991(c)	10,636.6	42,277	191.4	2,624.7	10,432	47.2	648.6	2,578	11.7	3,860.2	15,343	69.5	3,503.1	13,924	63.0

(a) Federal government debt excludes portion held by Federal Reserve and government agencies.

(b) 1990 figures based on quarterly average.

(c) 1991 figures based on first quarter statistics.

Source: Board of Governors of the Federal Reserve System; Bureau of Economic Analysis, Department of Commerce, Bureau of the Census; and Tax Foundation computations.

U.S. Debt from page 4

decade with a \$73.8 billion deficit in FY80, lawmakers nearly tripled that deficit in two years. Significant reductions in FY84 and FY87 did not arrest the upward trend, and with an expected FY92 budget deficit of \$348 billion, public debt and its associated interest costs are expected to pass the \$5 trillion mark by FY95.

While federal debt is the largest portion of U.S. liabilities, it is by no means the total. Accounts payable, pensions, and actuarial liabilities such as veterans compensation bring the total to \$3.77 trillion, \$1.61 trillion more than the public debt reported, and even this larger figure does not take Social Security into account.

State and Local Debt

State and local government debt makes up the smallest portion of the debt pie. It totaled \$642.2 billion in 1990, and as a percent of GNP, state/local government debt remained at a fairly consistent rate of 11 percent in the past decade. However, in light of the current fiscal crises in many states, debt levels for state governments are likely to grow more rapidly in the 1990s than they did in the 1980s.

Household Debt

Household debt, comprised mainly of mortgages and consumer credit, increased from 52 percent of GNP in 1980 to 68 percent in 1990. The largest portion of total debt, household debt peaked in 1990 at \$3.7 trillion, or \$14,929 for every member of the household.

The rise in consumer debt can be illustrated by the rapid jump in credit card usage throughout the 1980s. While credit card spending rose 93 percent, from \$205.4 billion in 1980 to \$397.1 billion in 1988, credit card debt increased even faster, a 122 percent rise from \$81.2 billion to \$180 billion. Credit card debt, as opposed to spending, refers to the debit balance amount carried over from month to month.

Non-Financial Business Debt

Second to households, non-financial business is the largest borrowing sector in the economy. During a decade famous for leveraged buyouts and junk bond financing, debt for non-financial businesses leaped from \$1.4 trillion in 1980 to \$3.5 trillion in 1990. ■

Tax Burdens from page 1

larger share of the income tax bill over the course of the decade. The top five percent paid 43.6 percent in 1989, up from 37.6 in 1979; the top 25 percent paid 76.5 percent of the taxes paid in 1989, compared to 73.1 percent in 1979;

bias of the tax cuts and rate reductions under the Economic Recovery Tax Act of 1981 and the Tax Reform Act of 1986.

Growth in the income base itself has been increasing faster at the upper end of the income scale, resulting in increased income tax receipts from top earners. Naturally, this also results in a

Federal Income Taxes Paid by High and Low-Income Taxpayers, 1979 and 1989^a

Adjusted Gross Income Class	Income Level		Percent of Tax Paid		Average Tax	
	1979	1989	1979	1989	1979	1989
Highest 5%	\$39,000 or more	\$77,568 or more	37.8%	43.6%	\$17,407	\$35,541
Highest 10%	32,710 or more	61,780 or more	49.5	54.5	11,456	22,225
Highest 25%	21,760 or more	37,064 or more	73.1	76.5	6,769	12,470
Highest 50%	11,870 or more	18,852 or more	93.2	93.9	4,315	7,658
Lowest 50%	11,869 or less	18,851 or less	6.8	6.1	313	496
Lowest 25%	5,565 or less	8,465 or less	0.5	0.7	46	122
Lowest 10% ^b	2,212 or less	3,047 or less	c	c	9	43

^a Data for 1989 are preliminary.

^b Includes returns showing no adjusted gross income.

^c Less than .1 percent.

Source: Tax Foundation computations based on Statistics of Income, Internal Revenue Service, U.S. Department of the Treasury.

and the top half increased its lion's share from 93.2 to 93.9 percent.

The lower half's share of income taxes paid dropped 11 percent over the decade. These taxpayers, whose AGI

higher proportion of the entire population's income being taxed at the highest rate

The 112 million returns filed for tax year 1989 reported an increase in AGI of

1989 Income Tax Data

Adjusted Gross Income Class	Total Individual Returns (thousands)	Total Adjusted Gross Income (\$billions)	Percent of Adjusted Gross Income	Average Tax Rate
Highest 5%	5,614	\$933.7	28.4%	21.4%
Highest 10%	11,228	1,276.9	38.9	19.5
Highest 25%	28,070	2,067.5	62.8	16.9
Highest 50%	56,140	2,833.1	86.1	15.2
Lowest 50%	56,140	458.3	13.9	6.1
Lowest 25%	28,070	82.5	2.5	4.1
Lowest 10% ^a	11,228	-13.8	-	-

^a Includes returns showing no adjusted gross income.

Source: Tax Foundation computations based on Statistics of Income, Internal Revenue Service, U.S. Department of the Treasury.

ranged from \$18,851 down to zero in 1989, paid 6.1 percent of total taxes, down from 6.8 percent in 1979. The lowest 25 percent paid a slightly higher percentage of collections, up from .5 percent in 1979 to .7 percent in 1989.

Trends in Progressivity

The federal income tax system has remained progressive. Top earners continue to pay a larger share of tax collections despite the alleged upper-income

\$194 billion over 1988. The largest percentage gain in income was from Individual Retirement Account distributions, up 24.3 percent from 1988. Social Security benefits rose 22.4 percent, and taxable interest increased 15.5 percent. Salaries and wages, which constituted 71.6 percent of total positive income for 1989, rose 5.5 percent over 1988. All told, 1989 total individual income taxes rose \$23.3 billion over 1988 for a record \$439 billion take. ■

Tax Foundation Pursues State Tax Policy Issues in Illinois

Just days after Illinois lawmakers had wrapped up a hard-fought budget battle in Springfield, they repaired to Chicago

"[With the new tax impact statements] citizens can now go to those local government budget meetings in advance of final adoption, and do the howling that they have only been able to do when they receive their tax bills."

**— Jim Nowlan,
President, Taxpayers'
Federation of Illinois**

to join corporate executives, university scholars, and members of the business press at a Tax Foundation program on state tax policy on the afternoon of July 24th. The overall theme was the relationship of tax policy to economic growth, and more specifically, how Illinois had mired itself in fiscal problems and to what extent the new budget would extricate it.

The State Budget in Crisis

"Illinois' Ailing Fiscal Condition—Is



From left: Paul Merski, Director of Fiscal Affairs, Tax Foundation; Dawn Clark Netsch, Comptroller, State of Illinois; Mark Horning, Associate Editor, *Crain's Chicago Business*; and John Skorburg, Chief Economist, Chicago Association of Commerce and Industry.

There a Cure?" was the question posed to the first panel. The subject was addressed by Dawn Clark Netsch, Comptroller, State of Illinois; Richard S. Winder, Director of State and Local Taxes, Household International; Sen. Howard W. Carroll, Chairman, Appropriations Committee, Illinois General Assembly; James D. Nowlan, President, Taxpayers Federation of Illinois; Patrick Quinn, Treasurer, State of Illinois; and John Skorburg, Chief Economist, Chicago Association of



From left: Thomas A. Dowd, Vice President - Corporate Tax, CNA Insurance; Dawn Clark Netsch, Comptroller, State of Illinois; Mark Horning, Associate Editor, *Crain's Chicago Business*; Dan Witt, Executive Director, Tax Foundation; and Sen. Howard W. Carroll, Chairman, Appropriations Committee, Illinois General Assembly.

"Nine of the last eleven fiscal years . . . we have spent more than we have received."

**— Dawn Clark Netsch,
Illinois State Comptroller**

Commerce and Industry.

Mark Horning, Associate Editor of *Crain's Chicago Business* moderated the panel and gave a brief rundown of the new state budget's highlights in his introduction. "About \$13 billion of a total \$27 billion budget will be spent for general revenue purposes. Of that \$13 billion, approximately \$6 billion will be spent on human services, \$5 billion on education, and more than \$2.4 billion on administrative costs of government. . . . There was a budget deficit of \$1.8 billion Approximately \$600 million in health care costs are being moved off the general revenue ledger to a new assessment system. . . . \$400 million will

be closed by creative accounting. . . . Finally, the last \$800 million are assorted amounts of cuts. The lion's share of the cuts, about \$380 to \$400 million, came in the area of human services . . . [with] the remaining \$400 to \$420 million in cuts coming from assorted areas of government."

From Short-Term Repair to Long-Term Strategies

"Mapping Out Long-Term Policies for Economic Growth" was the theme of

"We need to set up procedures or methods to limit spending, or somehow tie spending to the revenues that are realistically available. . . . Another possibility would be to consolidate agencies."

**— Richard S. Winder,
Director, State & Local Taxes
Household International**

the second panel. James L. Johnston, Senior Economist, Amoco Corporation, moderated the panel which included Toni Hartrich, Director of Research, Civic

See Illinois Tax Policy on page 7

Illinois Tax Policy from page 6

Federation; Don Haider, Director, Kellogg School of Management, Northwestern University; J. Thomas Johnson, National



Patrick Quinn, Treasurer, State of Illinois

Director - State and Local Taxes, Grant Thornton; Sen. Martin J. Butler, Appropriations Committee, Illinois General Assembly; Rep. Barbara Flynn Currie, Chairman, House Revenue Committee, Illinois General Assembly; Fred H. Montgomery, Senior Tax Attorney, Sara Lee Corporation; and Paul M. Green, Director, Institute for Public Policy, Governors State University.

Both Sen. Butler and Thomas Johnson remarked ruefully that the state seems to do its planning on a 24-hour

"I frequently hear that the income tax rates in Illinois are low, but we have to keep in mind that the base is relatively broad."

**— Fred H. Montgomery,
Senior Tax Attorney,
Sara Lee Corporation**

basis. Johnson urged a more farsighted approach, not just on the revenue side, where complaints about inaccurate estimates have been heard in state capitals throughout the nation, but also on the spending side, where the pattern of rapidly accelerating expenditures, especially on Medicaid and corrections, is well established but often shunted aside as too unpleasant to face.

Butler said the state must consider

FOUNDATION MESSAGE

"Tax Fairness" and Tax Facts

As Soviet political events unfold more dramatically each day, the tax policy scene in Washington is in the midst of a typically sleepy August. Congress led the charge of vacationers leaving town, but unlike recent August recesses when their departure broke off heated budget negotiations, 1991 has been a year of rhetorical sparring between Republicans and Democrats as they probe for weaknesses to exploit on the hustings in 1992.

"Tax fairness" is the label put on a variety of acrimonious charges the parties have been exchanging. Since the Tax Foundation has been monitoring government taxation as objectively as possible for more than fifty years, we are in a good position to referee such an argument.

The allegation is often repeated that tax legislation has dramatically changed the percentage of taxes paid by different income classes. After all, we have had so many major tax bills passed in the last decade, it does seem to make common sense that the balance of the tax burden would shift. Some say the middle class has borne the brunt of higher taxes, especially as Social Security rates have risen sharply, and the percentage of the median family's income subject to Social Security taxes has risen from 70 to 140 percent.

Just as often we hear that the poor got the worst of the eighties — higher excise and sales taxes are usually the culprit here. And although the average person probably has less sympathy with the tax troubles of wealthier Americans, the eighties saw the demise of hundreds of tax loopholes and incentives, and the decade ended with a new higher income tax rate for approximately the top two percent of taxpayers.

So how do all these claims sort out? The simplest answer is that they're all right — *everyone* is paying higher taxes. Total taxes as a percentage of total income is 35.1 percent in 1991, the largest fraction of the economy to be commandeered by government in U.S. history. But as the cost of government grows, so too does the need to know who is picking up the biggest share of the bill.

One big clue is the annual release of federal individual income tax return data. For tax year 1989, just released, it shows conclusively that the distribution of the tax burden has not shifted dramatically over the course of the decade (see article on page 1). The portion paid by the top half has varied less than two percent, while the share paid by the top ten percent has grown slowly from a low of 48 percent in 1981 to a high of 56.9 percent in 1988, before ticking down slightly to 54.5 percent according to the new 1989 data.

Of course, federal income taxes are not the whole fairness picture, and the Foundation is currently undertaking an exhaustive study of the total federal and state tax burden by income class by state. We look forward to helping the public with our research to understand in the most complete way possible who is bearing the burden of American taxes.



**Dan Witt
Executive Director**

business as an equal partner with labor and the state government. Until they do so and prove that the state has "a legislature that business can believe in and that has some understanding of what keeps a business thriving," Illinois will not achieve long-term economic growth.

Montgomery singled out the fran-

chise tax as a major deterrent to capital formation and economic growth in the state, while Paul Green said, "My solution is simple: we need fewer people in state government; we need them to work harder; and we need to be able to hire and fire them." ■

Next in Series of State Tax Policy Seminars To Be Held in Pittsburgh October 8

8:30 a.m. Registration/Coffee

9:00-11:45 Welcome:

Dan Witt, Executive Director
Tax Foundation

Moderator:

William Flanagan, Money Editor
KDKA - TV

Speakers:

Catherine Baker Knoll, Treasurer
State of Pennsylvania

John Dankosky, Executive Director
Pennsylvania Business Roundtable

Michael H. Herschock,*

Budget Secretary
State of Pennsylvania

Rep. Joseph R. Pitts,* Republican
Chair, Appropriations Committee
Pennsylvania General Assembly

Stuart Hoffman,*

Chief Economist
Pittsburgh National Bank

Don Eberly

President, Commonwealth Foundation

Lewis B. Lee, Director - State Division
Pennsylvania Economy League, Inc.

Albert E. Germain,

Vice President Taxes & Tax Counsel
ALCOA

John D. Luffe, Director of U.S. Taxes
PPG Industries, Inc.

Chairman, Tax Committee,
Pennsylvania Chamber of Business &
Industry

Robert P. Strauss,

School of Urban and Public Affairs
Carnegie Mellon University

Charles L. Potter, Partner; CPA
Rose, Schmidt, Hasley & DiSalle

12:00-1:30

Luncheon

Speaker to be announced

*Invited

Floyd Williams Joins Tax Foundation As Chief Tax Counsel

Floyd L. Williams, III has joined the Tax Foundation's staff as chief tax counsel. He comes with a variety of Washington tax law experience, most recently as staff vice president and legislative counsel for the National Association of Home Builders. He supervised the writing of all proposed legislation, Congressional testimony and statements. He maintained contact with government agencies, Members of Congress, and congressional staffs, and supervised the preparation of articles, newsletters, and conference presentations, which kept members apprised of legislative developments.

Before joining the Home Builders, he spent two years with Coopers & Lybrand as a senior tax manager for their National Tax Consulting Group. There he dealt primarily with partnerships, tax-exempt bonds, and tax shelter issues.

Mr. Williams' stint at Coopers & Lybrand was preceded by eleven years of government service, four years at the Internal Revenue Service and seven years with the Joint Committee on Taxation.

Mr. Williams received his law degree from the University of Arkansas after attending the University of Virginia for his undergraduate degree. He received his LL.M. in taxation at the Georgetown University Law Center in 1977.



Floyd L. Williams, III

Tax Features

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Tax Features

Foundation Sponsors Economic Conference In Moscow; Leads Corporate Delegation

The Tax Foundation will cosponsor the US-USSR Conference on Trade and Bilateral Economic Relations to be held in the Kremlin in Moscow November 30–December 8, 1991. Tax Foundation Co-Chairman James C. Miller III will co-chair the

Recent deregulation making foreign investment more attractive, along with the long-term initiative of bringing business and economic education to the youth of the Soviet Union, make this conference an important event to the delegates, to the people of the Soviet Union, and ultimately to the world.

conference along with Arkady Volsky, Director of the League of Scientific and Industrial Associations. Soviet President Mikhail Gorbachev and Russian President Boris Yeltsin are expected to address the conference.

Several hundred business leaders, entrepreneurs, academicians and policymakers from both the Soviet Union and the United States will attend the conference, which will include manufacturing site visits and other opportunities for them to acquire insight into the state of the economy and its prospects for investment. Interested parties should call the Foundation at 202-863-7651.

American delegates will be mostly corporate chief executives invited by the Tax Foundation. The Foundation's additional role is to assemble faculty members who will conduct seminars and panel discussions. At the plenary session, the American speakers will include James C. Miller III; James B. Hayes, Publisher of *Fortune*, John Sculley, Chairman & CEO of Apple Computer, Inc.; and senior U.S. government officials.

The conference comes at a pivotal time in the Soviet Union's transition to a market economy. The recent deregulation making foreign investment more attractive, along with the long-term initiative of bringing business and economic education to the youth of the Soviet Union, make this conference an important event to the delegates, to the people of the Soviet Union, and ultimately to the world. ■

FRONT BURNER

Enterprise Zones: A Development Alternative



Rep. Charles B. Rangel

The concept of enterprise zones has been floating around for several years. It originated in Great Britain where it was tried with some moderate success by the Thatcher government. It was brought to America by Jack Kemp when he was a Member of Congress, and he found a willing ally in then South Bronx Congressman Bob Garcia.

The underlying theory of enterprise zones is that economically moribund communities can be developed better by private sector investment than by government bureaucracy. Instead of government grants with bells and whistles, regulations, and political competition for those who are to receive government largess, an enterprise zone program sets forth benefits, usually as tax relief, and allows whoever qualifies to take advantage of them. It should have no application process and little or no bureaucracy. It is meant to be an efficient partnership of the public and private sectors.

As the idea has evolved, an enterprise zone program is a package of tax and other incentives designed primarily to encourage small businesses to locate or expand in the chosen zones. The incentives should be designed to facilitate the raising of capital and improvement of cash flow. These two goals are essential for small businesses. The most persistent financial problems for small businesses in their formative years, especially for minority entrepreneurs, are raising capital to get started and maintaining an adequate cash flow to keep operating. Examples of incentives to meet these needs are wage credits designed to lower payroll costs

See Rangel on page 2

Representative Charles B. Rangel, Democrat from New York's 16th district, is a member of the House Ways and Means Committee and Chairman of its Subcommittee on Select Revenue Measures.

The opinions expressed in the Front Burner are not necessarily those of the Tax Foundation. Editorial replies are encouraged.



Tax Foundation

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Rangel from page 1

and favorable capital gains treatment and deductions for investors to bring in capital.

To maximize the partnership between the Federal program and state and local governments, criteria for choosing

The underlying theory of enterprise zones is that economically moribund communities can be developed better by private sector investment than by government bureaucracy.

zones should be partly based on the level of state and local support for the zone. Besides tax incentives, the state and local governments could improve infrastructure, education and provide utility discounts among other incentives.

While getting its first exposure during the Reagan years, enterprise zones received only limited support from President Reagan's Administration. The only serious Congressional response during the 1980s was the passage of a provision to allow the Secretary of Housing and Urban Development (HUD) to designate enterprise zones. No incentives were provided for these zones.

All the while, 37 states established with varied success their own enterprise zone programs. But the states simply could not provide enough in the way of tax and other incentives to motivate enough businesses to move into a zone.

With the election of President Bush and selection of Jack Kemp as HUD

Secretary, enterprise zones were given new life. Secretary Kemp announced that enterprise zones would be a key-stone of his effort to revitalize urban development, and the President included an enterprise zone proposal in his initial budget. It called for a modest program for 25 zones costing about \$1.5 billion over five years.

Former House Speaker Jim Wright, who believed there were many Democrats who shared Kemp's view, asked me to spearhead the Democratic effort on enterprise zones. I introduced H.R. 6. It was based on the Kemp-Garcia bills of past Congresses and was introduced to gain public support for the concept. While it offered several incentives, it was unrealistic because it would have probably resulted in an unacceptably high revenue loss before any return could be expected from the revitalized zones. With Secretary Kemp's help in promoting the bill, it gained over 220 cosponsors in the House.

When it became clear by early 1990 that the concept had broad support in the House, Ways & Means Committee Chairman Dan Rostenkowski convened hearings on the matter and in response drafted his own legislation. He designed a program to cost no more than the \$1.5 billion over five years that the President had offered in his budget.

An enterprise zone program should have no application process and little or no bureaucracy.

Chairman Rostenkowski's proposal is somewhat different from Secretary Kemp's concept. While the incentives are similar and there is also a strong emphasis on the participation of the state and local governments, the Chairman's proposal assumes that there must be limits put on incentives in any zone to insure that the estimate of \$1.5 billion over five years is not exceeded. He is convinced that without limits on incentives for each zone, the program's costs could skyrocket and cause unacceptably high revenue losses in the early years of the program.

The Rostenkowski proposal limits zones to 11 square miles and caps the amount of benefits that can be claimed

annually in each zone. To allocate the benefits, the state or local government administering the zone would have to appoint a program director, or as some have called the position, a "Zone Czar."

While Secretary Kemp accepts the area limitation, he is completely at odds with the idea of dollar limitations on the benefits that can be claimed in a zone and the appointment of a "Zone Czar."

While Secretary Kemp accepts the area limitation, he is completely at odds with the idea of dollar limitations on the benefits that can be claimed in a zone and the appointment of a "Zone Czar." He views the involvement of the bureaucracy as counteracting the effort to empower entrepreneurs to make their own decisions.

He views the involvement of the bureaucracy as counteracting the effort to empower entrepreneurs to make their own decisions. The idea of limits and a Czar are not fundamental to the Chairman's view of the program. His position is born out of the President's reluctance to spend on the program and the belief that without the limitations, the amount budgeted would surely be exceeded.

I am confident a compromise can be reached for future consideration. Hopefully, when an agreement is reached on raising revenues to pay for other vital programs, enterprise zones will be part of the package. I look forward to seeing this experiment work. It could open an avenue to prosperity in communities where despair is now the prevalent feeling. ■

Correction

Our July issue incorrectly reported the testimony of James J. Renier, chairman and chief executive officer of Honeywell Inc, at the Ways and Means Committee's hearings on international competitiveness. It should have said that Honeywell is now a stronger international competitor due to a fundamental restructuring in 1986, not due to the restructuring of the tax code that took place that year.

Mark Your Calendars

November 20, 1991

for the

**Tax Foundation's
54th Annual Dinner &
43rd National Conference
at the Waldorf-Astoria
in
New York City**

Senator Baucus to Receive Distinguished Service Award for the Public Sector



Sen. Max Baucus

Max Baucus, Democratic Senator from Montana, will receive the Tax Foundation's 1991 Distinguished Service Award for the Public Sector at the Foundation's annual dinner

to be held on November 20 in New York City. A major policy address by the senator will follow his acceptance.

Senator Baucus is the third ranking Democrat on the Senate Finance Committee, serves on its subcommittee on

taxation, and chairs its subcommittee on international trade.

He has been extremely active of late in the area of tax code simplification. He has sponsored the Payroll Tax Deposit Simplification Act of 1991, which could benefit small and medium-sized businesses by drastically streamlining the payment schedule of payroll taxes. For example, current law calls for payment of a \$3,000 per month liability within three banking days after the 3rd, 7th, 11th, 15th, 19th, 22nd, 25th, and last day of the month. Senator Baucus's proposal would require liabilities of any amount less than \$6,000 per month to be deposited by the 15th day of the next month.

Nor has his work in simplification ignored the concerns of large multina-

tional corporations. With the Foreign Tax Simplification Act of 1991, he proposes to reduce compliance costs and administrative burdens in connection with U.S. taxation of foreign income, and to change the PFIC test from one based on gross income to one based on gross receipts, just to name two of its provisions.

Senator Baucus was born in Helena, Montana in 1941. He graduated from Stanford University with a B.A. in economics and received his LL.B. from Stanford Law School in 1967. He was elected to the U.S. House of Representatives in 1974 where he served two terms. He won his current seat in the Senate in 1978 and was reelected in 1984 and 1990. ■

Next in Series of State Tax Policy Seminars To Be Held in Pittsburgh October 8

The recent fiscal crisis in Pennsylvania has intensified the debate over sound tax and budget policies. To provide a forum for continuing this debate, the Tax Foundation has collaborated with several organizations to assemble state fiscal policy experts on Tuesday, October 8. Speaking to the theme *Pennsylvania Tax Policy: The Outlook for Economic Growth*, the panelists will examine the economic impact of tax changes and spending limitations as well as the outlook for future fiscal policy initiatives. Co-sponsors include the Allegheny Tax Society, The Commonwealth Foundation, the Greater Pittsburgh Chamber of Commerce, the Pennsylvania Business Roundtable, the Pennsylvania Chamber of Business and Industry, the Pennsylva-

nia Economy League, Inc., the Philip Morris Companies, the Pittsburgh Tax Club, and the Tax Executives Institute, Inc., Pittsburgh Chapter.

8:30 a.m. Registration/Coffee

9:00-
11:45

Welcome:
Dan Witt, Executive Director
Tax Foundation

Moderator:
William Flanagan, Money Editor
KDKA - TV

Speakers:
Catherine Baker Knoll, Treasurer
State of Pennsylvania

John Dankosky, Executive Director
Pennsylvania Business Roundtable

*Michael H. Herschcock
Budget Secretary
State of Pennsylvania

Prof. Kevin C. Sontheimer
Chairman of Economics
University of Pittsburgh

Paul Flora, Regional Economist
PNC Financial Corp.

Don Eberly, President
The Commonwealth Foundation

Lewis B. Lee, Director - State Division
Pennsylvania Economy League, Inc.

Albert E. Germain,
Vice President Taxes & Tax Counsel
ALCOA

John D. Luffe, Director of U.S. Taxes
PPG Industries, Inc.
Chairman, Tax Committee, Pennsylvania
Chamber of Business & Industry

Robert P. Strauss,
School of Urban and Public Affairs
Carnegie Mellon University

Charles L. Potter, Partner; CPA
Rose, Schmidt, Hasley & DiSalle

12:00-
1:30

Luncheon
John Fund, Editorial Writer
Wall Street Journal

*Congressman Rick Santorum (R-PA)
U.S. House of Representatives

*Invited

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Typical Family \$362 Poorer in 1991 Due to Rising Federal Taxes and Inflation; Taxes Dominate Family Budget

Accelerating federal taxes will combine with inflation to reduce the purchasing power of the American family by \$362 dollars in 1991, according to a Tax Foundation Issue Brief titled *American Family Losing Ground to Taxes and Inflation* by Paul G. Merski. The typical family — a household with two earners employed full-time, year-round with two dependent children — will suffer this loss in real income in 1991 after losing purchasing power in two of the three prior years for a 4-year loss of \$695 since 1988. The \$362 loss this year is the largest one-year decline since 1981 (see figure 1 and table 1).

The two-earner family making \$29,627 back in 1980 is now earning \$53,265. But when federal taxes and inflation have taken their cuts from this \$23,638 increase, a mere \$2,835 net gain is left, nearly a 90 percent loss.

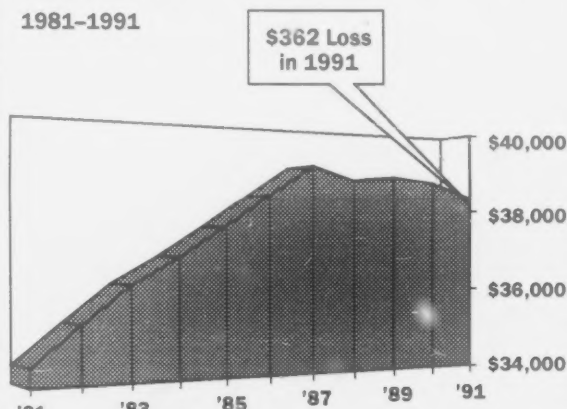
The Bite of Direct Federal Taxes

Since 1980, the typical family's federal income tax bill has risen 60 percent

Figure 1

Median Family Income After Federal Taxes and Inflation

1981-1991



Source: Tax Foundation (see table below).

despite two major income tax rate reductions: the Economic Recovery Tax Act of 1981 and the Tax Reform Act of 1986. They did lighten the income tax burden, but their benefits to the typical family have been overwhelmed, principally by

the rising toll of the Social Security tax. Six times since 1981, the Social Security tax rate has increased so that it now takes in 7.65 percent of the family's earnings, up from 6.1 percent in 1980. The level of earnings to which this tax is applied has also been ratcheted up due to automatic inflation adjustments. The combination of higher rates and a broader base has enlarged the bite that Social Security takes out of the typical family's income to \$4,075 in 1991.

Combined, income and Social Security taxes will absorb 19.8 percent of family income in 1991, down only slightly from the 1981 peak of 20.3 percent. The federal income tax, which claimed 13.7 percent of the family's total income in 1980, fell to a low of 11.8 percent in

1985 before rising to its present 12.2 percent level. The family made its biggest gains in the mid-1980s when real income rose an average of \$768 per year between 1982 and 1987 (see figure 2).

Table 1

Two-Earner Median Family Income Before and After Direct and Indirect Federal Taxes and Inflation 1980-1991

Year	Two-earner median family income ^a	Federal Taxes				After-Tax Income		1991 Income Gain/(Loss)
		Direct Taxes		Indirect Taxes ^c	Total	Current Dollars	1991 Dollars ^d	
		Income Tax ^b	Social Security					
1980	\$ 29,627	\$ 4,050	\$ 1,816	\$ 2,149	\$ 8,015	\$ 21,612	\$ 35,512	-
1981	32,224	4,386	2,143	2,579	9,108	23,116	34,432	(\$ 1,080)
1982	34,515	4,450	2,313	2,564	9,327	25,188	35,341	909
1983	36,106	4,300	2,419	2,752	9,471	26,635	36,209	868
1984	38,713	4,634	2,710	3,108	10,452	28,261	36,829	620
1985	40,593	4,787	2,862	3,098	10,747	29,846	37,557	728
1986	42,492	5,158	3,038	3,285	11,481	31,011	38,311	753
1987	44,536	5,291	3,184	3,305	11,780	32,756	39,042	731
1988	46,658	5,618	3,504	3,714	12,836	33,822	38,711	(331)
1989	49,090	6,022	3,687	3,812	13,521	35,569	38,839	128
1990	52,011	6,527	3,979	4,140	14,646	37,365	38,709	(130)
1991 ^e	53,265	6,493	4,075	4,350	14,918	38,347	38,347	(362)

^a Median income for household with two earners employed full-time, year-round.

^b Married couple filing joint return, two dependent children.

^c Estimated average indirect federal taxes. Includes excise taxes, employer's share of Social Security taxes, and miscellaneous levies.

^d Adjusted by consumer price index (CPI-U), estimated 3.6% inflation in 1991.

^e Estimates based on first quarter 1991 statistics.

Sources: Tax Foundation; U.S. Department of Commerce, Bureau of the Census and Bureau of Economic Analysis; U.S. Department of Labor, Bureau of Labor Statistics; U.S. Treasury Department, Internal Revenue Service.

Indirect Federal Taxes

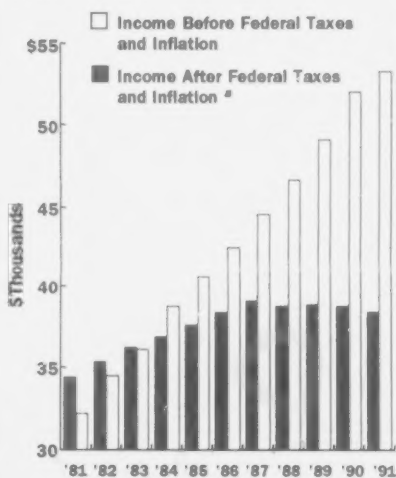
Individual income taxes and Social Security "contributions" are direct federal taxes which appear as withheld income on the typical American worker's paycheck. But they are only part of the federal tax take. Numerous federal taxes are indirect; that is, government imposes them directly on industry. This can mean lower wages for workers, higher prices for consumers, and lower returns for investors. Some examples of these indirect taxes are the employer's share of Social Security taxes; excise taxes on products and services such as gasoline, liquor, tobacco, and telephone use; and miscellaneous taxes. All together, these claim a significant portion of the typical family's earnings.

Last year's budget agreement, the Omnibus Budget Reconciliation Act of 1990, increased many of these indirect taxes, notably on gasoline (9 to 14 cents per gallon), cigarettes (16 to 20 cents per pack), beer (16 to 32 cents per 6-pack), wine (3 to 21 cents per bottle), and the telephone excise tax (permanently 3 percent). While the amount of these taxes varies with each family's income and consumption patterns, the typical

Figure 2

Family Income Before/After Federal Taxes and Inflation

1981-1991



(a) Income after federal taxes and inflation computed in 1991 dollars.

Source: Tax Foundation

of 1990 has severely reduced the average American family's income growth.

How the Family Spends What's Left

The family's first obligation after federal taxes is to state and local governments, which will collect an estimated \$5,273 in taxes, making government's total cost to the average family a hefty 37.9 percent of all income, by far the largest item in the family budget (see figure 3). After paying all federal, state and local taxes, from its \$53,265 annual earnings, the family is left with \$33,074 in disposable income to spend or save.

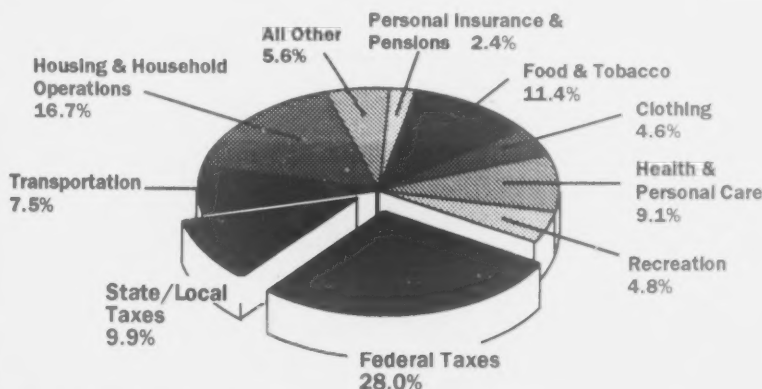
The family spends the bulk of its disposable income on four items: housing and household operations - 16.7 percent; food and tobacco - 11.4 percent; health care - 9.1 percent; and transportation - 7.5 percent. After taxes and these expenses, less than 18 percent of the family's income is left for such items as clothing, recreation and savings.

Outlook for the Family

Despite the typical family's record-high tax payments in 1991, persistent federal deficits of over \$300 billion will keep the pressure on to increase federal

Figure 3

Typical American Family Budget in 1991*



Spending Category	Dollar Amount	Percent of Income
Family Income	\$53,265	100.0%
Total Taxes	20,191	37.9
Federal Taxes	14,918	28.0
State and Local Taxes	5,273	9.9
After Tax Income	33,074	62.1
Total Personal Consumption Expenditures	33,074	62.1
Housing and Household Operations	8,920	16.7
Food and Tobacco	6,056	11.4
Health/Personal care	4,849	9.1
Transportation	4,009	7.5
Recreation	2,543	4.8
Clothing	2,454	4.6
Personal Insurance and Pensions	1,254	2.4
All Other	2,989	5.6

* Typical defined as a two earner family earning \$53,265 per year with two dependent children.

family examined here will pay an estimated \$4,350 in indirect federal taxes in 1991. That adds up to a record-high 8.2 percent of the family's 1991 earnings.

The Impact of Inflation

The upswing in inflation is another reason for the decline in the typical family's purchasing power in 1991. Infla-

tion, which stood at 13.5 percent in 1980, declined steadily to a low of 1.9 percent in 1986, giving the growth rate in family income a chance to grow in real terms. Inflation has accelerated since 1986, however, and it is estimated at 3.6 percent for 1991. It was relatively low during the first half of 1991, but the economic slowdown that began in the last quarter

tax revenues. Sharp tax increases recently enacted in many states will continue to tap the family's disposable income over the next several years. These tax increase pressures, along with the upswing in inflation and slower income growth, do not bode well for the American family's purchasing power in the coming years. ■

Major State Taxes and Rates

as of August 1, 1991

State	Income Taxes		General Sales and Use Tax	Gasoline Tax (per gallon)	Cigarette Tax (per pack of 20)	Property Tax
	Corporate	Individual				
Alabama	5% (F)	2 to 5% (F)	4% (a)	11 cents	18.5 cents	X
Alaska	1 to 9.4	none	none	8	29	X
Arizona	9.3	3.8 to 7	5 (a)	18	18	X
Arkansas	1 to 6.5	1 to 7	4.5 (a)	18.5	22	X
California	9.3 (c)	1 to 11 (c)	6 (a,d)	15 (b)	35	X
Colorado	5 to 5.2 (d)	5 (c)	3 (a)	22	20	X
Connecticut	11.5 (f)	4.5 (g)	8 (d)	23 (b)	40 (b)	X
Delaware	8.7 (w)	3.2 to 7.7	none	19 (l)	34	
District of Columbia	10 (f)	6 to 9.5 (f)	6	18	30	X
Florida	5.5 (c)	none	6 (a)	4 (r)	33.9	X
Georgia	6% of taxable net income	1 to 6	4 (a)	7.5 + 3% of retail	12	X
Hawaii	4.4 to 6.4	2 to 10	4 (a)	24.8 to 32.5 (v)	40% of wholesale	
Idaho	8	2 to 8.2	5	22 (v)	18	X
Illinois	4.8 (h)	3 (h)	6.25 (a)	19 (d,w)	30	X
Indiana	3.4 (l)	3.4	5	15	15.5	X
Iowa	6 to 12 (F,j)	.4 to 9.98 (c,F)	4 (a)	20	36	
Kansas	4.5 (f)	3.65 to 5.15 (k)	4.25 (a)	17 (b)	24	X
Kentucky	4 to 8.25	2 to 6	6 (a)	15 (e)	3	X
Louisiana	4 to 8 (F)	2 to 6 (F)	4 (a)	20	20	X
Maine	3.5 to 8.93	2 to 8.5 (o)	6 (d)	19	37	X
Maryland	7	2 to 5	5	18.5	16	X
Massachusetts	9.5 (e,m)	6.25 (n)	5	21 (e)	26	X
Michigan	2.35	4.6	4	15	25	X
Minnesota	9.8 (c)	6 to 8.5	6.5 (e,d)	20.25	43	X
Mississippi	3 to 5	3 to 5	8	18 (d)	18	X
Missouri	5 to 6.5 (d,F)	1.5 to 6 (F)	4.225 (a,d)	11	13	X
Montana	6.75 (f,s)	2 to 11 (F)	none	20	18	X
Nebraska	5.58 to 7.81	2.37 to 6.92	5 (a)	23.71 (v)	27	X
Nevada	none	none	5.75 (a,b)	18	35	X
New Hampshire	8	5 (g)	none	18	25	X
New Jersey	9 (f,t)	2 to 7	7	10.5	40	X
New Mexico	4.8 to 7.6	1.8 to 8.5	5	16.2	15	X
New York	9 (c,d,e,f,u)	4 to 7.875 (d,p)	4 (a)	8	39	
North Carolina	7.75 (f)	6 to 7.75	4 (a)	22.6 (v)	5	X
North Dakota	3 to 10.5 (c,F)	2.67 to 12 (F,q)	5	17 (d)	29	X
Ohio	5.1 to 8.9	.743 to 6.9	5 (a)	21 (v)	18	X
Oklahoma	6	.5 to 7 (k,F)	4.5 (a)	16 (e)	23	
Oregon	6.6	5 to 9 (F)	none	20	28	X
Pennsylvania	12.25	3.1 (d)	6 (a)	12	31	X
Rhode Island	9 (f)	27.5 % of modified Federal income tax	7	26 (e)	37	X
South Carolina	5	2.5 to 7	5 (a)	18	7	X
South Dakota	none	none	4 (a)	18	23	
Tennessee	6 (g)	6 (g)	5.5 (a)	21 (w)	13	
Texas	none	none	6.25 (a)	20	41	
Vermont	5.5 to 8.25	28% of federal income tax liability (d,o)	5	15	18 (b)	X
Virginia	6	2 to 5.75	3.5 (a)	17.5	2.5	X
West Virginia	9.15	3 to 6.5 (c)	6	15.5	17	X
Washington	none	none	6.5 (a)	23 (l)	34 (d)	X
Wisconsin	7.9	4.9 to 6.93	5 (a)	22.5 (l)	30 (e)	X
Wyoming	none	none	3 (a)	9 (l)	12	X

(X) Indicates property tax levied.

(F) Allows federal income tax as a deduction.

(a) Local taxes are additional.

(b) Future increases scheduled under current law. As of October 1, 1991, CT gas tax -25 cents, and cigarette tax -45 cents.

(c) Alternative minimum tax is imposed.

(d) Future reductions scheduled under current law. CT sales tax drops to 6% October 1, 1991.

(e) Alternative methods of calculation may be required.

(f) Corporate surtax is imposed, CT - 20%, DC - 5%, KS - 2.25%, NJ - .375%, NY - 15%, NC - 4%, ME - 10%, MT - 5%, RI - 11%. CT surtax scheduled to decrease to 10% in 1992 and be eliminated in 1993.

(g) In NH and TN, rates apply to income from dividends and interest. In CT, lower rates applied to income from interest and dividends. Additional changes in

deductions also added in 1991 for CT.

(h) Additional 1.5-2.5% personal property replacement tax imposed.

(i) A supplemental net income tax is imposed at 4.5%.

(j) Franchise tax is 5% of taxable net income.

(k) In KS and OK, higher rates may apply to taxpayers deducting federal income tax.

(l) Tax rate is periodically adjusted administratively.

(m) Excise tax is imposed equal to the greater of (a) \$2.60 (includes surtax) per \$1,000 of value of MA tangible property not taxed locally or net worth allocated to MA, plus 9.5% (includes surtax) of net income, or (b) \$400.

(n) Tax of 12% on income derived from interest, dividends, and capital gains.

(o) Income surtax imposed, ME - 5-15%, VT - 3-6%.

(p) Qualified taxpayers may elect to pay alternative taxes at varying rates.

(q) Election to be taxed on 14% of taxpayer's federal income tax liability.

(r) Additional county transportation tax levied.

(s) 7% rate for corporations using "water's edge" apportionment.

(t) A 7.25% corporation income tax is imposed on entire net income of foreign corporations not subject to the corporation business tax.

(u) Small business taxpayers are subject to a lower rate.

(v) Includes additional taxes or fees. Hawaii gas rates include county rates.

(w) Additional tax or surcharge imposed.

Sources: Compiled by Tax Foundation from survey of state revenue offices and data reported by Commerce Clearing House through July 1, 1991.

Thirty States Will Raise \$17 Billion in New FY'92 Taxes

State legislative sessions have staggered to a close around the country, with thirty states increasing tax rates for FY1992. This will raise a total of more than \$17 billion in new taxes, according to a new Special Report titled *Survey of State Taxes and Rates 1991* by Gregory Leong.

Gasoline and tobacco were the most popular targets as 23 states hiked the amounts they collect at the pump and 14 states raised their cigarette excises. The bulk of the new revenue will not come from excises, however, but rather from higher sales taxes in six states, and higher personal income taxes in eight states. Additionally, six states hiked corporate income tax rates. Only seven of the fifty states, Colorado, Connecticut, Kansas, North Dakota, Oklahoma, South Carolina, and West Virginia lowered any tax rates for the new fiscal year.

Individual Income Taxes

Eight states raised individual income tax rates, the most notable of which was Connecticut's new income tax. Texas and Tennessee also contemplated enacting an income tax, but Connecticut was

Gasoline and tobacco were the most popular targets as 22 states hiked the amounts they collect at the pump and 14 states raised their cigarette excises.

the only state to do so. Connecticut lawmakers repealed the taxes on capital gains, dividends, and interest income and replaced them with a flat 4.5 percent income tax that is estimated to bring in \$1.4 billion in additional FY'92 revenues. Rhode Island and Vermont, which base their income tax on federal tax liability, also hiked their rates. Pennsylvania raised its flat rate from 2.1 to 3.1 percent while California, Massachusetts, Nebraska, and North Carolina raised their marginal rates for top income earners.

Rates in three states, Kansas, Oklahoma, and South Carolina, dropped for

Moscow Business Conference Promotes Long-Term U.S. Competitiveness

While headlines focus on the tidal wave of political transformations that are taking place from Cuba to Cambodia after the fall of the Soviet Union's communist party, it is time for America to capitalize on the changes. International trade is becoming a larger part of every nation's economy, and interdependence across national borders is now a dominant feature of the corporate landscape. Therefore, it is vital for the sake of corporate efficiency and economic growth for U.S. tax policy to be neutral with respect to international transactions. Promotion of this concept is one of the primary goals of the Tax Foundation's international tax assessment project.

Naturally, even if the U.S. achieves this goal, it cannot single-handedly create international tax harmony — the posture of other nations' tax policies affects our own and must be addressed. The Tax Foundation has conducted numerous programs that have brought together tax executives of U.S.- and foreign-based multinational corporations, university scholars, and U.S. government officials to discuss these issues. But foreign government officials also need to be apprised of our perspective on international taxation. Of course, they know from official statements and actions the position of the U.S. government, and they regularly hear from their own taxpayers. But in a global economy, it is entirely appropriate and necessary for independent programs like those of the Tax Foundation to provide an objective forum where foreign government officials can hear from another group who must live with the consequences of their tax policy — American taxpayers.

One such effort was a series of conferences in the European Community last January. The Foundation led a delegation, which included corporate tax executives and staff members from the House Ways and Means Committee, the Senate Finance Committee, and the Joint Tax Committee, to meet senior government finance officials in London, Paris, Bonn, and Brussels. These meetings were especially successful in promoting mutual understanding among fiscal authorities of our concepts of taxation.

December's trip to Moscow (see p. 1) has, of course, a much broader mission. Tax Foundation Co-Chairman James C. Miller III will lead the Foundation's corporate members in an effort to educate Soviet businessmen, government officials, and students on the creation of economic growth through entrepreneurial activity. The mixture of programs will include panel sessions on such complexities as international tax treaties, as well as plenary sessions on such basic free market concepts as banking, capital formation, and private property.

It is not inconceivable that the Soviet Union will someday be a major U.S. trading partner like the Western European nations we visited in January. By helping to lay the groundwork now for a sound economic structure in the Soviet Union, the Tax Foundation is building hope for the world's economic future.



Dan Witt
Executive Director

FY'92. South Carolina enacted the final phase of a previously passed income tax reduction, lowering the bottom marginal rate from 3 to 2.5 percent.

Alaska, Florida, Nevada, South Dakota, Texas, Washington, and Wyoming retain the distinction of being the only seven states which levy no individual

income tax. Tennessee and New Hampshire exempt wages and salaries but tax income from interest and dividends. The six states which use a flat tax rate for all income — Colorado, Illinois, Indiana, Massachusetts, Michigan, and Pennsylvania — will be joined by Connecticut in

See State Taxes on page 8

State Taxes from page 7

October 1991. In the remaining 34 states and the District of Columbia, income tax rate schedules remain progressive.

Corporate Income Taxes

Six states — Arkansas, Kentucky, Minnesota, Nebraska, North Carolina, and Pennsylvania — raised corporate income tax rates for FY'92 while two states, Colorado and West Virginia, lowered them. Pennsylvania enacted the

Texas and Tennessee also contemplated enacting an income tax, but Connecticut was the only state to do so.

largest percentage increase, 44 percent, and consequently has the highest marginal corporate tax rate in the nation, 12.25 percent.

Iowa's 12 percent rate is now second highest, followed by North Dakota, 10.5 percent, and Minnesota, 9.8 percent. (This ranking is based solely on marginal tax rates and does take into account either surtaxes or alternative minimum taxes, where imposed.) Five states levy no corporate income tax: Nevada, South Dakota, Texas, Washington, and Wyoming.

Sales Taxes

Since sales taxes are the mainstay of revenue for the states, many states con-

tinued to increase rates or broaden the taxable bases by subjecting more goods and services to the tax. Six states — Arkansas, California, Maine, Minnesota, North Carolina, and Vermont — increased their sales tax for FY'92. The most notable changes occurred in California and Connecticut. California imposed the largest rate increase, from 4.75 to 6 percent. Connecticut, which had the highest sales tax in the nation last year, 8 percent, will reduce its rate to 6 percent, effective October 1, 1991. New Jersey and Rhode Island now lead the nation with sales tax rates of 7 percent, followed by Minnesota and Washington, 6.5 percent, and Illinois and Texas, 6.25 percent. Five states — Alaska, Delaware, Montana, New Hampshire, and Oregon — do not impose a sales and use tax.

Excise Taxes**Motor Fuels Tax**

Excise taxes were a focus in almost all the legislatures, especially motor fuels (23 states) and cigarettes (14 states). California and Rhode Island enacted the largest motor fuel tax increases, both raising it six cents per gallon. Hawaii added five cents per gallon and still imposes the highest gasoline tax in the nation — the combined state-local tax ranges from 24.8 to 32.5 cents per gallon. Rhode Island (26 cents), Nebraska (23.71 cents), and Connecticut and Washington (23 cents) follow closely behind. Florida levies the lowest rate, 4 cents; but gaso-

line is also subject to a 6.9 percent general sales tax. Alaska and New York have the next lowest rates at 8 cents.

Cigarette Tax

Pennsylvania and the District of Columbia imposed the largest tax increases on cigarettes in the nation, jumping 13 cents to 31 cents and 30 cents per pack respectively. Minnesota tops the ranks with a 43 cent rate per pack but will soon fall to second when Connecticut's increase to 45 cents takes effect October 1, 1991. Other states with high rates include Texas (41 cents), New Jersey (40 cents), New York (39 cents) and Rhode Island and Maine (37 cents). Kentucky and North Carolina levy the lowest rates at 3 cents and 5 cents respectively. (See table on page 6 for more details.) ■

Tax Features

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